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The only man who could make it happen

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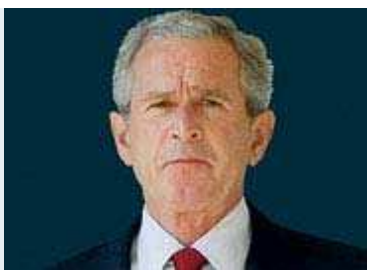

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Politics this week

Nov 22nd 2007
From The Economist print edition

AFP

At least 3,000 people—and perhaps as many as 10,000—died after a cyclone hit the coast of **Bangladesh** bringing a tidal surge five metres high. Some 5m people were affected. Many were soon short of food and drinking water because of the difficulty of reaching the disaster area. See article

Pakistan's election commission confirmed that a general election would be held on January 8th. The reconstituted Supreme Court rejected challenges to the re-election of General Pervez Musharraf as president; he is now expected to step down as chief of the army. Meanwhile, thousands of people fled fighting between the army and pro-Taliban militants in the northern district of Swat.

On the eve of **Australia's** general election the opposition Labor Party, led by Kevin Rudd, maintained a strong lead in the opinion polls over the government of John Howard, who has been prime minister for 11 years.

At a summit meeting in Singapore to mark its 40th anniversary, the **Association of South-East Asian Nations** (**ASEAN**) adopted a charter committing them to promote human rights and democracy. Critics suggested that the presence at the summit of the prime minister of Myanmar, and his approval of the charter, showed it to be a sham. See article

Japan became the second country, after America, to fingerprint and photograph all foreigners who arrive in the country. It justified the measure on counter-terrorism grounds, but critics scented racial discrimination. See article

Giving thanks

George Bush was apparently “very pleased” at a breakthrough in **stem-cell research**. Scientists now say they can use ordinary skin cells to replicate techniques that currently employ embryonic stem cells. Mr Bush vetoed two bills in the past that sought to expand the use of embryonic stem cells for research, arguing that such procedures destroy life. See article

America's Supreme Court agreed to hear a case as to whether the second amendment to the constitution gives **the right to “bear arms”** to individuals. At issue is a long-standing ban in Washington, DC, on the ownership of guns, which a court has decided is unconstitutional. The case will be heard next spring.

Ending months of speculation, **New Hampshire** set the date of its primary election for January 8th. With Iowa holding caucuses on January 3rd there will be no respite from campaigning for candidates (or voters) over Christmas. See article

Ready, steady, talk

A summit meeting between **Israelis** and **Palestinians**, hosted by President George Bush in the port of Annapolis, Maryland, was set for November 27th. It remained unclear whether the Saudis and/or Syrians would attend, and if so at what level. The American secretary of state, Condoleezza Rice, said the meeting would be deemed a success if it launched Israeli-Palestinian negotiations to create a Palestinian state. Expectations were fairly low. See article

Lebanon's bitterly opposed political groups, mainly pitting Sunnis against Shias and with Christians themselves divided, again failed to find a compromise over the choice of a new president, who must be chosen by parliament by November 23rd. Fears grew that sectarian rancour may lead to renewed violence.

Iraq's displacement and migration minister said that 1,600 people were returning to Iraq every day because of the improving security in the capital, though some 2m Iraqis who have fled the violence remain abroad, mainly in Syria and Jordan.

Reuters

Candidates loyal to **Jordan's** King Abdullah appeared to have done well in a general election, whereas the Islamists, who are close to the Muslim Brotherhood and have been the main legal opposition, did much worse than before. In any event, the king still calls the shots. See article

South Africa's president, Thabo Mbeki, said that anyone convicted of political offences before June 1999 could apply for a pardon. The post-apartheid Truth and Reconciliation Commission had covered those cases up to 1994.

The **World Health Organisation** said that the number of people with HIV is 33m, fewer than it had previously reckoned. Better data collection in India and five African countries explains the apparent fall. Some 2.1m people died of AIDS last year, down from a peak of 2.2m in 2005. See article

A way out for Castro?

Raul Castro, **Cuba's** acting leader, announced that national and municipal elections will take place on January 20th. The newly-elected National Assembly will then elect a new ruling Council of State. This could turn into a test of whether the ailing Fidel Castro can continue in his titular role as president. See article

Canada ordered an inquiry into the use of Tasers after a video was broadcast showing an unarmed Polish man howling in agony after being zapped with a stun gun by the Royal Canadian Mounted Police at Vancouver airport. The man, who had flown to Canada to live with his aged mother, died soon after.

Sarkozy's big test

Huge transport strikes continued in **France** against the government's pension reforms. Sabotage against high-speed trains was also reported. With other aggrieved groups joining in, mostly on one-day strikes, President Nicolas Sarkozy vowed to stand firm, though negotiations continued behind closed doors. See article

Jacques Chirac, the previous French president, was formally charged by investigating magistrates with embezzlement during his tenure as mayor of Paris. See article

AP

Russia's president, Vladimir Putin, staged an enormous rally in Moscow to boost his United Russia party ahead of parliamentary elections and denounced the opposition for behaving like jackals in seeking foreign cash. The Russian authorities have denied visas to foreign election-observers.

A gas explosion in a **Ukrainian mine** killed 90 people. It was the worst mining accident in a country whose mines were already among the most dangerous in the world.

Gordon Brown, **Britain's** prime minister, ordered government departments to check their data-handling procedures after it was revealed that two CDs containing personal information on 25m benefit recipients were put in the internal post, and had subsequently disappeared. See article

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Business this week

Nov 22nd 2007
From The Economist print edition

Freddie Mac, one of America's two government-sponsored mortgage giants, reported a net loss of $2.03 billion for the third quarter and blamed “weakening house prices and deteriorating credit” for its woes. Fannie Mae, its larger rival, recently announced a quarterly loss of $1.4 billion. Both handle around $4.8 trillion in housing loans and were set up by the government partly as a bulwark against times of crisis in financial markets. See article

The share price of **Countrywide Financial**, America's biggest private mortgage-lender, fell by around 22% in intraday trading amid rumours it was about to run out of cash. The company has been dogged by reports that it is on the verge of bankruptcy since the turmoil in money markets began in the summer. It denied the latest speculation and its share price recovered.

More data pointed to a deepening slump in America's **housing market**. Permits to erect homes, an indicator of future building, fell in October to the lowest level in 14 years. Actual construction starts on single-family homes fell by 7% compared with September. There was one glimmer of hope: more condominiums meant total construction starts rose by an unexpected 3%.

Northern crock

Northern Rock, a British bank afflicted by the credit crunch and which is now being propped up by public money, said it had received more expressions of interest about a takeover, though some of the offers came in below its already-depressed share price. More calls were made for Northern Rock to be nationalised and its assets sold. See article

The fallout from the credit-market crisis spread to the reinsurance industry when **Swiss Re** took a SFr1.2 billion ($1.1 billion) write-down stemming from its exposure to subprime-mortgage related debt. The company's revelation came two weeks after buoyant quarterly earnings that gave no hint of the loss.

DP World raised almost $5 billion in its initial public offering, the biggest ever in the Middle East. Owned by the emirate of Dubai, the port and logistics company was caught in a political squall last year when it bought some operations in the United States.

ArcelorMittal said it was talking to **China Oriental Group** about increasing its holding in the firm. The world's biggest steelmaker took a 28% stake in its Chinese rival earlier this month. China's government has resisted attempts by foreigners, so far, to take control of Chinese steel producers.

Beer buddies

SABMiller's offer to buy **Grolsch** for *euro*816m ($1.2 billion) was accepted by the Dutch brewer. Grolsch is one of the world's oldest breweries, tracing its roots to 1615. It sells most of its beer in Britain and the Netherlands, but SABMiller thinks Grolsch will go down well in emerging markets too. The deal left Anheuser-Busch standing at the bar; America's biggest brewer markets Grolsch in the United States and was interested in an acquisition.

TomTom, the market leader in satellite-navigation devices, made formal its offer to buy **Tele Atlas**, a maker of digital maps, after **Garmin** conceded defeat for its rival bid. TomTom amassed a 28% stake in Tele Atlas, its Dutch compatriot, during negotiations.

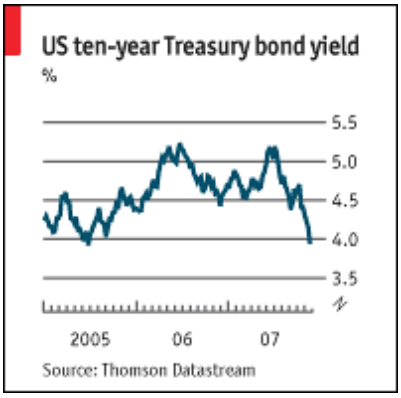
Amazon took the wraps off its new portable digital book-reader. The **Kindle** allows its users to download books and magazines for a fee and, unlike similar devices, has a wireless connection. A revolution in reading habits through e-books has long been promised by retailers, but many analysts remain sceptical. See article

Hewlett-Packard reported a strong quarter that helped its annual sales (for the year ending October 31st) push past $100 billion for the first time.

Gap posted a healthy increase in quarterly profit, though sales remained flat. The company is revamping its Gap and Old Navy clothing lines in response to miserable pre-Christmas trading last year. All **retailers** will be nervously checking their shop fronts and online stores this year in the hope of a stampede of American consumers in lavish mood after Thanksgiving. Some surveys indicate they may be disappointed.

A port in a storm

With **stockmarkets** wobbling and the **dollar** falling, investors sought refuge in safer bets. The yield on ten-year **Treasury bonds** fell below 4% for the first time since 2005. There was little solace for markets in the release of the minutes of the Federal Open Market Committee's latest meeting, which predicted slower economic growth next year. Optimists took that to mean another interest-rate cut is on the cards. The Fed has specifically warned markets not to expect such a decision at its next gathering.



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KAL's cartoon

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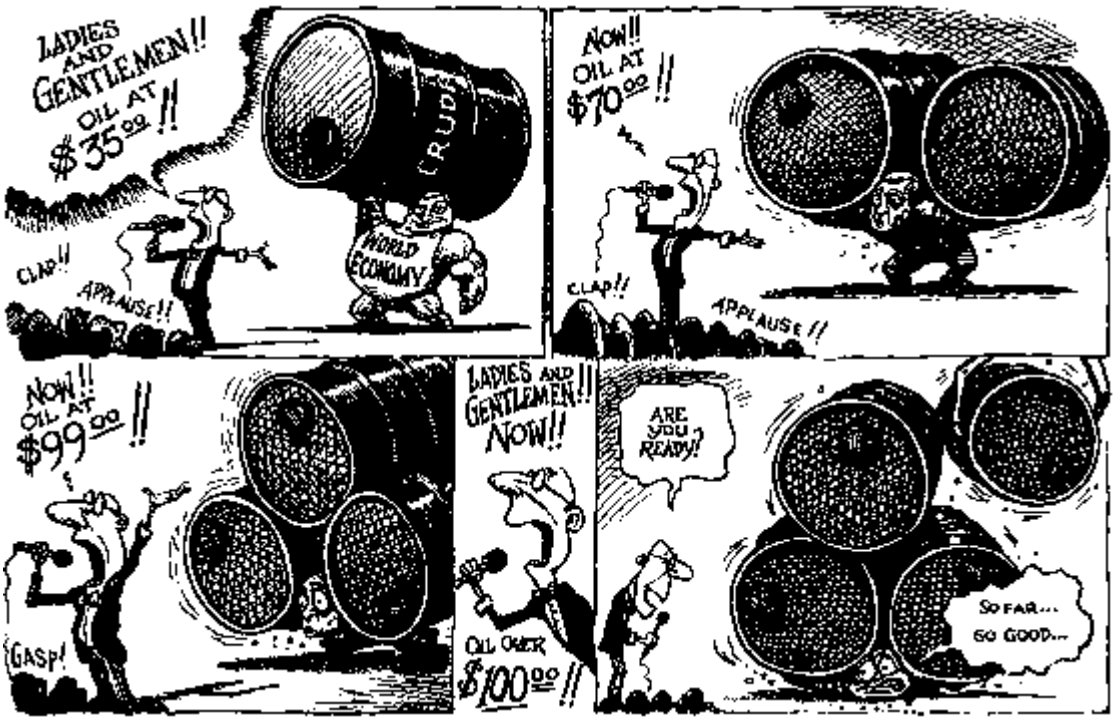
Illustration by Kevin Kallaugher



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The Middle East summit

Mr Palestine

Nov 22nd 2007
From The Economist print edition

George Bush is the only man who can bring an independent Palestine closer

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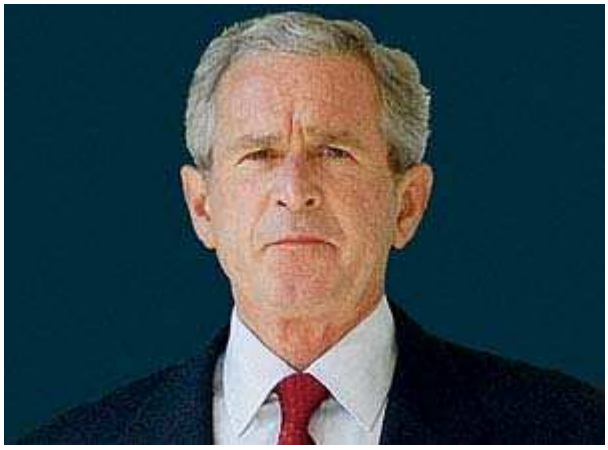

Get article background

GEORGE BUSH is not likely to be remembered by history as the saviour of the Middle East. He botched Iraq, dropped his democratic “freedom agenda” when the Arabs started voting for the wrong people, and has spent most of his two terms more or less ignoring Palestine. On this last front, however, he now has an opportunity for redemption.

If all goes to plan, Mr Bush will preside on November 27th over a peace meeting in Annapolis, Maryland. Expectations of this one-day event are at rock bottom. Nobody foresees much more than some bland speechifying and a photo-opportunity. And yet, if he is bold, Mr Bush has it in his power to turn Annapolis into a significant step towards peace. All he has to do is pluck up the courage to make the right speech.

Please come, we promise nothing will happen...

That may sound like a wild claim to make of an event already shrouded in defeatism. This is a party nobody is thrilled to have been asked to. Ehud Olmert is going because an Israeli prime minister cannot leave an invitation from the White House to curl in the in-tray. Mahmoud Abbas is going because after losing the Gaza Strip to Hamas he must show that he is still president of Palestine, if only in the eyes of the great powers. Not even the hosts seem excited. Condoleezza Rice, America's secretary of state, is a genuine if late convert to the idea that America can budge things in Palestine. But the rest of the administration appears to see Annapolis as a way to roll out the customary pieties on Palestine and so make it easier for America to line up its Arab friends against Iran.

Worse still, these modest ambitions have shrivelled as the day has (see article). Plan A was for Mr Olmert and Mr Abbas to talk to one another before Annapolis and make a joint declaration when they arrived. To give the Palestinians what Ms Rice calls a “political horizon” (ie, hope) this declaration was supposed to go beyond Mr Bush's oft-repeated but ephemeral “vision” of an independent Palestine and fill in the vital missing detail on borders, refugees and Jerusalem. But although the two sides have indeed talked in recent weeks they have not bridged their longstanding differences.

That is no surprise. With Hamas snapping at his heels, it would take immense courage for the timorous Mr Abbas to modify the Palestinians' mantra: a state on the 1967 borders, a capital in Jerusalem and the “right” of the refugees of 60 years ago to return to what is now Israel. And although Mr Olmert is at least

the prime minister of a functioning state, he governs in coalition with men who hate the very idea of an independent Palestine and have worked sedulously to tie his hands. Polls show that many Israelis long to be rid of the Palestinian territories. But even they wonder how they can trust Mr Abbas's ramshackle Palestinian Authority to police a state when it has already lost Gaza to the rocket-firing rejectionists of Hamas and might well lose the West Bank too.

In the absence of a pre-Annapolis meeting of minds, America has therefore moved to Plan B. There may still be a joint declaration, but it will be vague. It will pay homage to the principle of two states and recite the relevant, long-ago United Nations resolutions, which both sides know by heart but interpret differently. The two sides may then promise to sit down together the day after Annapolis to talk about borders, refugees and Jerusalem, with the hope of reaching agreement within a year. In the meantime, Tony Blair, in his new guise as the UN's midwife for Palestine, will set out his plans to strengthen the economy and institutions of the West Bank in preparation for the independence that will come, some day.

Are such modest aims worth going to Annapolis for? Just about. If Mr Bush gets the Saudis and Syrians as well as the Egyptians and Jordanians to show support in Maryland, this may boost and embolden Mr Abbas, at least for a while. If Annapolis leads to economic help and makes Israel free up movement on the West Bank, the life of many Palestinians will improve. If talks about borders, refugees and Jerusalem really do start right away, this will be a change: Israel previously cited the “road map” of 2003 as a reason to pickle final-status negotiations in formaldehyde until the PA uprooted the Palestinian militias. And if Israel honours its own obligation to freeze settlement in the territories, this may persuade some of the Palestinians who have good reason to doubt it that there will still be room one day for a state of their own.

Plan B, in short, is probably better than nothing. But if he dares, Mr Bush has it within his power to make Annapolis so much more. He cannot bring a free Palestine into being at a stroke, or even within the final year of his own presidency. The Israelis are right to say that the divided Palestinians are in no shape right now to govern a state: at some point Hamas has first to be bullied, bribed or cajoled into accepting Israel's permanence and joining the peace camp. But Annapolis does offer Mr Bush the perfect chance to make a speech that could set the Palestinians fair on the path to statehood, and leave America's next president in a far better position to finish the job.

...unless George W. Solomon turns up too

In this speech Mr Bush needs to set out forthrightly America's own plan for dividing Palestine. That would mark an historic change. In the past—in Madrid in 1991, for example, and at Camp David in 2000—the Americans asked the Israelis and Palestinians to thrash out their differences on their own. But they can't. The gap is too wide, and even when their respective leaders want to narrow it neither dares move towards the other for fear of the uproar from the ideological bitter-enders at home. The existence of an American blueprint that commanded international support would, however, immediately transform the political dynamic of both societies, fortifying the moderates and pushing the hardliners to the margins.

Although it would be too much to expect Mr Bush to unfurl a map at Annapolis, he could come quite close. For a start, he should make it clear that when America talks of a two-state solution, it has in mind a border based on the pre-1967 line. Three years ago Mr Bush said in a public letter to Ariel Sharon that it would be unrealistic to expect Israel to evacuate all the dense settlement blocks it has planted in the West Bank. Fine. But since most settlers live close to the old border, he can now tell Israel that it cannot keep more than a few percentage points—say 5% or so—of the West Bank, and that it must offer the Palestinians land from its own side in compensation. On refugees, Mr Bush should say, as Bill Clinton did, that their right to “return” should be exercised in the new Palestine and not in pre-1967 Israel: that is a bitter pill but it is the logic of a peace based on partition. And Israel too must accept a bitter potion: Jerusalem, the beating heart of both peoples, will have to be the capital of both.

If Mr Bush gives this speech, Mr Olmert and Mr Abbas will wax furious. They might agree with him in their hearts, but if only for domestic political consumption they will have to accuse the American president of setting an ambush, bullying the little guys, prejudging the final-status issues and riding roughshod over the views and rights of the people most directly affected. These fulminations can be safely ignored. Israel and the Palestinian territories alike are full of politicians who will tell you knowingly but off the record that only a deal along the lines described above stands the remotest chance of bringing permanent peace. It is high time the superpower and the rest of the world threw their weight behind such a plan. The photo-op at Annapolis may be just the place to do it.

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Data protection

Lost in the post

Nov 22nd 2007
From The Economist print edition

Prepare for governments to lose plenty of personal information about you

Illustration by David Simonds

IT TAKES a lot to produce gasps of astonishment from British politicians. But that was what greeted Alistair Darling, the chancellor of the exchequer, when he told parliament on November 20th that two computer discs containing the personal details of 25m British individuals and 7m families had gone missing. The discs were being sent by internal mail between two government departments; they included names, addresses, bank-account details, dates of birth and names of spouses and children. The fate of the discs is unknown, but they contain just the sort of information sought after by identity thieves, who could use it to procure fake documents, commit fraud and empty bank accounts.

This is the latest in a series of such losses. HMRC, the tax-and-customs department which sent the discs, lost a laptop containing personal data on 400 people in September, and last month it lost another disk in the post, containing pension records for 15,000 people. But this week's fiasco is on an entirely different scale. It ranks alongside the theft of data on 26.5m people stolen from the home of an employee of the Department of Veterans Affairs in America in 2006, and the loss by Bank of America in 2005 of tapes containing information on 1m American government employees. And there have been dozens of smaller cases around the world in which personal data have been lost by, or stolen from, credit-card companies, online retailers, government departments and banks.

Fear of identity fraud means that many people now routinely shred receipts and sensitive documents before binning them. But identity thieves rarely waste time looking in dustbins any more. There is no point bothering to steal one person's details, when records can be had in their thousands and millions from leaky computer systems. Large databases have become central to the operation of governments, health systems, banks and other large companies. And despite the howls from libertarians, nobody really wants to turn back the clock and revert to paper records. What can be done?

As always with computer security, there are two things to remember. First, that security depends on a combination of technology and policy; and second, that no system is ever totally secure. It is safer to assume that there will be breaches, and work out how to minimise the damage. That means storing, and moving around, as little data as possible; anonymising records and linking to personal details stored in a separate database; and using encryption to protect data in transit. None of this was done by the HMRC. It was asked to supply anonymised data to the National Audit Office, but provided reams of unencrypted personal information instead (see article).

Regulation has a role to play, too. Many European countries and 35 American states have rules that require companies and government departments to disclose breaches of information security to anyone

affected. In many cases they are also legally liable for any loss. This gives them an incentive to store as little data as possible and to look after it properly. Britain, alas, has some of the most toothless data-protection rules in the developed world: the government recently rejected a plan to make reporting of breaches compulsory. According to one estimate, setting up new bank accounts for everyone affected by this week's leak could cost £300m ($600m).

Data debased

Even when sensible regulation is in place, however, it is no use if the rules are ignored—as in the most recent British case. So data-protection watchdogs need to be able to carry out spot checks to ensure that everything is being done by the book. But where other regulators, such as European antitrust investigators, have the power to carry out unexpected raids, Britain's data-protection watchdog does not. The government has pledged to change this, but as things stand, all it can do is issue HMRC with a warning not to make the same mistakes again.

Large databases have their uses, doing away with paperwork and speeding things up. But the centralisation of so much data also has drawbacks, as this week's mess shows. In its enthusiasm for huge technology projects, such as its plan for a national identity card, the British government has failed to take such dangers sufficiently seriously. And why should it, when its departments face no penalties for ignoring procedures and losing data? If organisations were confronted by the risks of building large databases and forced to balance them against the benefits they provide, they would design them differently and monitor their use more closely. Sometimes, they would decide that they were not worth building at all.

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Africa

Promises, promises

Nov 22nd 2007
From The Economist print edition

It is time for both Africans and the rich world to walk the talk in Darfur and Somalia

SELDOM has east Africa seen such turmoil. Eastern Congo faces a humanitarian disaster; the killing in Sudan's Darfur region goes on apace; war rages between Islamist militias and Ethiopian troops in Somalia; and rebels threaten the government in Chad. On top of that, war may resume between Eritrea and Ethiopia and between Sudan's government and former rebels in the autonomous south (see article).

As a result, the UN is sending unprecedented numbers of troops to the region. It already has 17,000 in Congo and 20,000 more are due to join an existing 6,000-strong African Union (AU) force in Darfur. These are the largest UN forces in the world. Another 2,000-odd are sandwiched between the Eritreans and the Ethiopians, plus 10,000 in south Sudan. The AU also has some 1,600 Ugandan troops under its command in Somalia's blighted capital, Mogadishu.

We accepted the mission, now give us the tools

The numbers alone look impressive, as befits the world's much-vaunted determination to help end Africa's bloodiest conflicts. In Congo, the UN is doing its best to hold the ring between several rival ragtag armies. But elsewhere its fine intentions have yet to bear fruit, especially in the two most pressing cases, Darfur and Somalia.

In Darfur the UN is due to start deploying its forces in a few weeks. The speed with which several African governments have offered troops has been a welcome surprise, suggesting a new-found willingness to bear a bigger burden of peacekeeping on their own continent. But now the effort risks failing all over again because of a dire lack of helicopters, a prime cause of the peacekeeping failure to date. In a region as big as France with no proper roads, the static AU force has been easy prey for rebels and government proxies alike. That makes it imperative for the UN to provide both transport and attack helicopters for its expanded force. A score might be enough to begin with, but since the Africans cannot provide even this number the choppers (and pilots) will have to come from elsewhere.

The government in Sudan's capital, Khartoum, may jib at the prospect of West Europeans or Americans providing or flying aircraft over Darfur, so it would be good if Russia or India were to help out. But even if they don't, a robust and mobile force is vital if peace is to be restored to a region where some 300,000 people have already died and more than 2m are displaced. Plenty of well-armed men intend to make the UN/AU force's job hard, especially as there is still no peace agreement to be monitored on the ground, as the Security Council hoped there might be when it voted to send in troops in July.

In Somalia, however, it is the African countries that have failed to deliver. In February the AU promised a force of 8,000 to keep the peace in Mogadishu, after Ethiopia's invading forces, with tacit Western approval, clobbered the Islamist militias to bolster a shaky Somali government. But so far only the Ugandans, too few to do the job, have turned up. So the Islamists have regrouped and war threatens to engulf the city again, perhaps infecting the whole region. Africa and the West, not to mention the UN, seem to have lost hope and interest. African governments, whose forces in Darfur are being paid for by the West, should pay some of their own way in Somalia, albeit with more help from the rich world. But the main foreign governments involved in the painful task of negotiation—Britain, Italy, Norway and America—must not give up.

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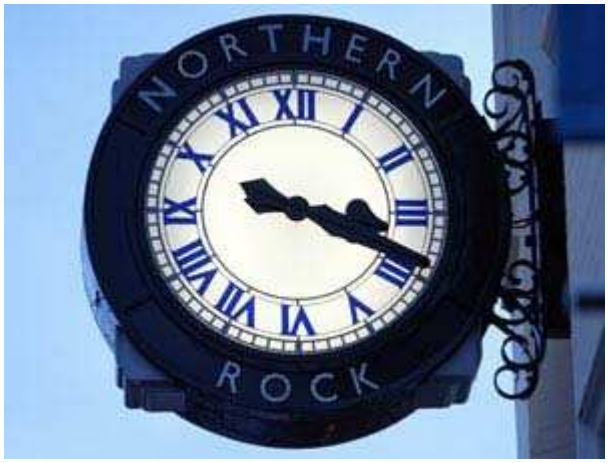
Northern Rock

Pulling the plug

Nov 22nd 2007
From The Economist print edition

The market has said what it thinks of Northern Rock. The British government should listen

Getty Images



EVERY banker knows John Paul Getty's dictum: “If you owe the bank $100 that's your problem. If you owe the bank $100m, that's the bank's problem.” What then of a bank that owes taxpayers some £24 billion ($49 billion), with another £18 billion or so of deposits underwritten by the public purse? Northern Rock, it seems, is everyone's problem.

The bank, once Britain's fastest-growing mortgage lender, is now a wreck. Having turned to the Bank of England for an emergency bail-out in August, it is unable to repay its loans unaided. Its debt to the central bank is growing. A mortgage book that was the envy of the industry looks less robust by the day. Its share price plummeted this week to less than £1, down from more than £12 at the beginning of the year.

The government finds itself in a deeply unenviable position. It is propping up Northern Rock's liabilities, yet the bank's assets belong to its shareholders. European rules prohibiting state aid to industries require ministers to cut the lifeline by March, or come up with a plausible reason not to. The Treasury is desperately casting around for buyers to take the bank and its problems off official hands, but none of the financial world's best and brightest is willing to assume full responsibility for it. All bidders so far have valued the bank well below even its current market capitalisation; all have asked for public-sector credit lines or loans.

There can be no good ending to this sorry saga, which had its origins in slack supervision, bad central-bank calls and a panic-stricken rescue that left offending bank bosses in charge for too long. But some outcomes are better than others.

Any solution must have two main goals in mind. The first is maintaining the stability of the financial system. For all that the first panic of the credit crunch seems past, there are too many uncertainties abroad to ride rough-shod over fairly fragile sentiment. The second is to get the taxpayer off the hook as fast and as thoroughly as possible. Depositors are protected by the guarantee the government has extended. It is hard not to feel sorry for the 145,000 retail investors who still hold Northern Rock stock; but they are entitled to no such guarantees and they must be aware that share prices go down as well as up.

There are three broad options confronting Alistair Darling, the chancellor of the exchequer, who will, in the end, decide Northern Rock's fate. The first is to sell the bank. The main bidders propose pumping more capital into Northern Rock, organising private lines of credit, repaying part of the government's loan

quickly and keeping at least some jobs. Such a deal would annoy the bank's shareholders, who would be bought out for some variation of a pittance; but if Mr Darling could find a private-sector buyer with a firm promise to repay taxpayers quickly, it would be a tidy solution.

The problem is that no such private-sector buyer seems to exist; everybody relies on Mr Darling underwriting the deal for a considerable amount of time. Such a subsidised sale would give the bank's new owners most of the upside, should gains emerge, while leaving the taxpayer with most of the risk, if losses ensued instead. This asymmetry is more than galling: it might well create a perverse incentive for the bank's new owners to gamble even more recklessly than its old ones. And other banks would rightly complain of unfair competition.

A second option is to force the bank into bankruptcy. This too holds few attractions. Deposits would most likely be frozen for weeks or even months. News of savers struggling to get their money back could spark runs on other banks. In the resulting firesale, Northern Rock's assets would probably fetch less than they are worth. And administration would trigger the winding-up of Granite, a vehicle that holds half the bank's mortgages as collateral against bonds issued. If it is liquidated, its cash would be used to pay those bondholders first. Some £7 billion in extra assets that it holds could be tied up for years.

Take it over

This newspaper has, to put it mildly, never been a fan of nationalisation. But with Northern Rock this increasingly looks like the least bad option from a taxpayer's point of view (unless a credible buyer appears). And, in any case, the damage is half-done: in effect the state already owns a chunk of it.

Were the government a distressed-debt hedge fund, it would be trying to assume control, squeeze out existing shareholders and get back the money it is owed. State control, with a view not to running the bank (a terrifying thought) but to running it down, would allow value to be extracted for taxpayers through the orderly sale of assets. Bankers could take some comfort from the government's ability to pace disposals according to the mood of the markets. And nationalisation would let the state retain any future gains by going slowly—or even entering into a private-sector partnership—in the somewhat unlikely event that credit markets, house prices and Northern Rock's reputation recovered soon.

To be sure, nationalisation would be messy. Shareholders might well sue. The lesson from other crises (France, Mexico, Sweden, Japan and so on) is that emergency state ownership should be brief and at arm's length; Mr Darling might meddle, keeping unprofitable parts of the business open to safeguard jobs in the relatively poor (and Labour-voting) north-east. Nevertheless, nationalisation looks the best choice of a bad lot, for it aligns risks and rewards most closely and keeps control in the hands of those who have most invested. But there should be no illusions that it is anything but a mercy killing.

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European migration

Fear of foreigners

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From The Economist print edition

A troubling upsurge of opposition in western Europe to migrants from eastern Europe

Report Digital

FEW people like change. So it is understandable if mass immigration causes concerns. It is less forgivable if political leaders fail to address those concerns. And it is not unforgivable if far-right parties exploit them in a racist way.

All these things seem to be happening in western Europe. In several recent elections, anti-immigrant parties on the far right have done well. A stream of would-be immigrants from Africa keep taking to leaky boats in the hope of reaching the Canary Islands or Malta. But the latest hostility has been aimed at the far larger numbers who have moved westwards from the new east European members of the European Union, notably Poland and Romania (see article).

The arguments over the benefits of immigration are fairly complicated. Immigrants themselves clearly gain, since they move usually in order to work for higher pay than they can get at home. There is some evidence that European economies that have taken in many migrant workers have also benefited, not only in total output but also in terms of GDP per head. However, some native workers, such as fruit-pickers, builders and waiters, obviously lose because immigration holds down their wages. Even this has an upside, since it has helped to hold down inflation in places like London.

In most of Europe there is another big reason for accepting more immigration: demography. Most countries, in western and eastern Europe alike, face the prospect of populations that will both age and shrink over the next 50 years. The implications for their economies and their public finances are worrying. One obvious answer is to boost the working-age population by admitting more immigrants. Eastern Europe, it is worth noting, will have to make up for those going west by itself taking in more migrants from farther afield.

The political trick that is urgently needed is not to try to stop this process, but to make it more palatable at home. That means not repeating the mistake just made by Italian politicians, who have demonised Romanian immigrants as potential and actual criminals and passed a decree making it easier to deport them. It means not asserting, as some British political leaders have, that Britain, Ireland and Sweden were wrong to open their labour markets to east Europeans in 2004.

It would be better if politicians explained patiently why the influx of Polish workers in Britain in the past few years has, on balance, done much good. As Britain's strong employment figures show, far from stealing British jobs, they have helped to create more, a point political leaders make all too seldom. Another thing they fail to say is that many immigrants from eastern Europe stay only for a short time. Already many construction workers from Poland and elsewhere are returning, partly because hot housing markets are cooling fast, partly because wages at home have risen in response to labour shortages.

On top of this, however, practical steps are needed to answer the valid concerns people have about immigration from the east. More language tuition should be offered to help immigrants to integrate. More money should be spent to improve infrastructure, such as schools, hospitals and roads, that is being put under extra pressure by an upsurge of immigrants. More work must go into improving education and training so that native workers can move more easily into higher-skilled jobs. These are all hard things to do; but most of them are part of good government anyway.

Enlargement at risk

Meanwhile, failing to tell the truth about immigration has another cost: it is stoking opposition to any further expansion of the European Union. Until recently most opinion polls were on balance favourable to the notion of further unifying the European continent by admitting the western Balkan countries, at least. But if enlargement is sullied in people's minds by their concerns about immigration, that balance could soon turn negative. One answer may be to promise voters long transition periods before the EU's full freedom of movement of labour is permitted for the poorest Balkan countries (let alone Turkey). But if more Europeans knew the truth about the benefits of the current wave of immigration, such political precautions would not be necessary.

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The dollar

Time to break free

Nov 22nd 2007
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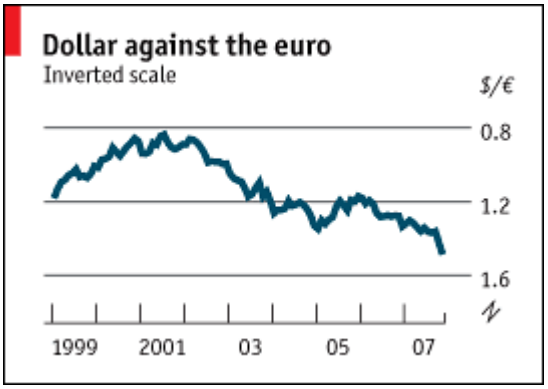
The Middle East's oil exporters should end their currencies' peg to the dollar.



IN THE past week Iran's president, Mahmoud Ahmadinejad, has damned it as a “worthless piece of paper” and China's premier, Wen Jiabao, has moaned that it is causing his country “big pressure”. The dollar's relentless decline—it hit a new low of $1.49 against the euro on November 21st—is prompting jibes from America's critics, jangling investors' nerves and giving policymakers headaches.

Nowhere are the dilemmas more acute than in the Gulf, where virtually all the oil-rich states peg their currencies to the greenback. The combination of soaring oil prices and the tumbling dollar is distorting their economies and fuelling inflation. When the Gulf states meet on December 3rd in Qatar, they should agree to loosen their ties to the dollar.

The argument for linking to the greenback was to provide an anchor for the region's economies, many of which are small, open and financially immature. In effect, the Gulf states import America's monetary policy. The trouble is that a fixed currency makes it hard for oil exporters to adjust to swings in the price of oil. And monetary policy in the world's largest oil-importer is not always right for those who sell the stuff.

Soaring oil prices have brought the Gulf Arabs huge riches. Their real exchange rates, as a result, ought to rise. The simplest way to do that is for the currency to strengthen, but the peg prevents nominal appreciation. Worse, the dollar itself has been falling. The result is rising domestic inflation. Some smaller Gulf economies now have inflation rates of around 10%.

What is to be done? The two most widely discussed options are to revalue or to shift to a currency basket (which Kuwait has already done). By repegging their currencies to the dollar at a higher rate, the Gulf states would alleviate some of today's inflationary pressure. But they would not address the underlying mismatch between any oil exporter and a dollar peg. Switching the peg to a basket of currencies that included, say, the euro and yen as well would give the Gulf states a bit more protection against oil-price swings, but it is hardly a perfect fit. Since most big currencies belong to oil importers, the Gulf States would still be linking their currencies to monetary conditions that may not suit them.

Eventually, the currency pegs should be abandoned. After all, developed economies that are big commodity exporters, such as Norway, allow their currencies to float. In recent years many emerging economies have shifted from exchange-rate pegs to a “managed float”. Instead of aiming for an exchange rate, their central banks have an inflation target. If the Gulf states move to a single currency, as they plan to in the next few years, that currency should surely float. But floating is not feasible in the short-term. These countries have no history of independent monetary policy and few institutions to conduct it.

Look beyond a basket

For the moment, the Gulf states are stuck with a currency peg. But they could do better than the dollar. One intriguing idea is to include the oil price as part of a basket that includes the leading currencies (see article). This would ensure their currencies absorbed some of the impact of oil-price swings.

A big uncertainty is what such a shift would mean for the dollar. In the short term, the effect on the Gulf

states' appetite for greenbacks would not be dramatic, since the dollar would have a big weight in any basket. And there should not be a sudden sale of the oil exporters' dollar reserves. The worry is that the end of the Gulf states' dollar peg would send jittery investors into a panic. That risk is real. But with oil prices rising and the dollar falling, the dangers of inaction are greater. The Gulf states need to get rid of their dollar peg now.

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On immigration, Florida, Britain and Europe, Ethiopia, Scotland, spying insects

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From The Economist print edition

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Not so swamped

SIR – Britain's political parties may well be converging on policies that place further restrictions on immigration ("Undercounted and over here", November 3rd). It is accurate to say that concern is widespread about an alleged laxity in British immigration policies. However, these "lax" policies do not stand up to international comparison. Given the size of its economy, the flow of immigrants to Britain from poor countries is proportionally low.

According to the Centre for Global Development, a think-tank in Washington, DC, Britain's borders are relatively closed to immigrants and refugees from poor countries. The centre ranks Britain 14th out of 21 OECD countries on the friendliness of its immigration policies. Recent trends have not improved that record. As is to be expected, nations of immigrants such as the United States, Canada, Australia and New Zealand score relatively high for opening their gates to the nationals of developing countries. But the fact that the borders of Austria, Denmark, Germany, Ireland, the Netherlands, Norway, Spain, Sweden and Switzerland are all more open to foreigners than those of Britain may come as a surprise to many.

Robert Picciotto
Visiting professor
King's College London
London

Sunshine state

SIR – Lexington frets that the "post-partisanship" politics of Arnold Schwarzenegger may not spread much beyond California (November 3rd). Lexington can find solace in another state that had once symbolised national polarisation: Florida. I voted against Charlie Crist in 2006, but in his first year as governor he has done more to re-enfranchise (mostly Democratic) black voters than any of his predecessors through his support for voting systems with paper records and the automatic restoration of voting rights for former felons. This has angered many of his fellow Republicans, but allowed meaningful relationships to be forged across the political aisle. In other areas pragmatism has almost always trumped partisanship. Mr Crist may not be as flashy as California's governor, but his post-partisanship appears to be every bit as meaningful.

Seth Kaplan
Miami Beach

Britain's place in Europe

SIR – Charlemagne describes how Britain's "disdain" towards the European Union is causing it to lose influence in "Europe's corridors of power" (November 3rd). All senior British civil servants have to negotiate with our partners and with the European Commission and European Parliament. Experience working within those bodies is the best training they can have. Immediate action is needed to remedy the reported drop in the number of British officials assigned within the EU.

Britain needs a good number of its citizens working full-time within these institutions, not because of the favours they might do for British governments, but because they will mostly come from the economically liberal, reformist British tradition, of which the EU needs a steady infusion.

Sir Stephen Wall
UK permanent representative to the European Union, 1995-2000
London

Ethiopia's record

SIR – While I appreciated your briefing on Ethiopia, I would note that you could have made much more of our involvement in the war on terror ("A brittle Western ally in the Horn of Africa", November 3rd). I would also point to your apparent reluctance to accept the reality of Ethiopia's recent economic growth. This growth has been led by exports, which breached the $1 billion barrier in 2006 and are expected to grow by another 20% this year. We have broken away from our dependence on coffee and have emerged from nowhere to become Africa's second-largest exporter of flowers.

Moreover, development is not confined to a "small building boom" in Addis Ababa. Change in other towns, such as Bahr Dar, Awasa and Mekele, is striking. Ethiopia currently has more than 90% enrolment in primary schools and will have universal primary health care by 2012. Of course more needs to be done and we are aware of the need to reduce our dependency on imported raw materials and to limit population growth. And yes, unemployment remains unacceptably high.

You forget that this government started from a low point following 17 years of doctrinaire Marxist blight. Thus it is doing rather better than you allow.

Berhanu Kebede
Ambassador for Ethiopia
London

English questions

SIR – I am surprised that such an experienced parliamentarian as Sir Malcolm Rifkind should fail to see the flaws in his proposal to create an English Grand Committee in Parliament to deal with purely English business (Letters, November 17th). It could work only if the majority in this committee mirrored a majority of the whole House of Commons, ie, that the government of the day held a majority because it had sufficient English seats to overcome Scottish, Welsh and Northern Irish representation. It could not work if a government held its majority thanks to the Celtic nations.

Sir Malcolm asked you to note that the whole House would continue to exercise control over tax and public expenditure. How could a government with a non-English majority, such as described, allow any grand committee to dictate legislation that would, inevitably, see it also dictating taxation and public expenditure to pay for that legislation?

Sir Malcolm, like me, a former Scottish member of parliament, knows all about grand committees that do not reflect the House majority. The Scottish Grand Committee, which had a Labour majority but operated in a House with a Tory majority, was allowed to discuss purely Scottish issues, but on non- contentious matters. A grand committee with powers to legislate and spend could never be allowed then, and could never be allowed now, unless the Tories have a majority where their English seats top the rest.

Jim Sillars
Edinburgh

A buzz issue

SIR – I read your briefing on unmanned aerial vehicles at about the same time I was finishing Ernst Jünger's novel, "The Glass Bees" ("The fly's a spy", November 3rd). It is remarkable that Jünger predicted current developments back in 1957. The UAVs he described were to be used in unmanned rescues, surveying, monitoring and various secret military applications. Even more interesting is his speculation about the future of the technology and its potential abuses.

He predicted tiny flying apparatuses that would be able to relieve the symptoms of allergy sufferers by picking the pollen out of the air. And, in a quantum leap beyond the current technology, envisioned squadrons of "unnatural insects" interacting and working as intelligent composite organisms, which is to say, as social insects do in nature.

Thomas Friese
Vienna

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The Annapolis summit

Cinderella at Annapolis

Nov 22nd 2007 | JERUSALEM, RAMALLAH AND WASHINGTON, DC
From The Economist print edition

Illustration by Peter Schrank

Muddled expectations and mismanaged diplomacy may mean that the Annapolis peace summit achieves far less than its backers once hoped

Get article background

WHAT many dreamed would be a gilded carriage carrying the Israeli and Palestinian leaders to a grand ball of peacemaking has turned back into a pumpkin before their eyes. A firm date of November 27th for the “international meeting” in Annapolis, Maryland, was set only a week before the event itself, and as this article went to press talks were continuing over the content and which Arab states would attend. Despite increasingly frantic shuttle diplomacy, Condoleezza Rice, George Bush's secretary of state, could not close the gap between the Israeli and Palestinian positions, forcing her to accept little more than the “photo-op” meeting that she had promised Annapolis would not become.

One reason was simple: the gulf between Israel and the Palestinians is indeed wide. Mahmoud Abbas, the Palestinian president, wanted Annapolis to pin down some of the “core issues” of the two-state peace deal agreed at the non-binding 2001 Taba talks; issues such as the overall quantity (if not the exact borders) of the land Israel would relinquish for a Palestinian state. He also wanted a firm, six-month deadline for completing peace talks. Ms Rice too wanted some sort of commitments. Israel, on the other hand, wanted them left vague. In private, its officials argued that Mr Abbas and Ehud Olmert, the Israeli prime minister, were so politically weak at home that if they made promises they could not keep, opponents would seize on the chance to undermine both them and the peace process.

A similar gulf within the Bush administration created confusion about what to expect. One group, led by Ms Rice, had high hopes for Annapolis. Another, including Elliott Abrams at the National Security Council, the main architect of America's Middle East policy, and Dick Cheney, the vice-president, was sceptical. This divide, explains M.J. Rosenberg at the Israel Policy Forum, a Washington think-tank, reflects a long-standing rift in policy circles between the faction that views the Israel-Palestine conflict as a key to America's other problems in the Middle East, and the more pro-Israel set that believes (and wants) it to be marginal.

Thus, while an open letter by a clutch of policy nabobs, including two of Ms Rice's predecessors, gave warning of “devastating consequences in the region and beyond” if the summit failed, Mr Cheney gave it only passing mention at a conference held by the pro-Israeli Washington Institute for Near East Policy in October. And even some of the summit's cheerleaders privately admit that Mr Bush probably never meant Annapolis to be such a big deal. “The Palestinians and Rice and types like me hyped it big time,” says a left-leaning Washington think-tanker, “because we are so desperate to see movement.”

After months of stalemate, Mr Abbas and Mr Olmert agreed to drop the dispute over core issues in favour of an agreement to launch final-status talks after Annapolis. Meanwhile, they would return to the “road map” peace plan of 2003.

Long since left for dead by most people—Mr Olmert himself gave it a “much less than 50%” chance of success when it was first launched—the road map initially requires the Palestinians to take action against militant groups while Israel is to freeze all construction on its settlements in the West Bank and dismantle dozens of unofficial outposts established by hardliners. Both sides are supposed to act in parallel, but in the past Israel has insisted that all militant groups be dismantled before it did anything. The Palestinians hoped that this time would be different.

Illustration by Peter Schrank

It was not to be. Once Mr Abbas had dropped his demand to predetermine core issues, Mr Olmert—perhaps sensing the Palestinian leader's weakness—began salami tactics on the new arrangement. He said he hoped to reach a final-status agreement with Mr Abbas by the end of Mr Bush's term in office, but its implementation would begin only once the first stage of the road map—“if the Palestinians dismantle terror infrastructure,” he specified—was over. In fact, the first stage calls on the Palestinian Authority (PA) to begin this process, not complete it. Then, said Mr Olmert, Israel would dismantle outposts, albeit without giving a timetable—and the construction freeze would apply only to new settlements, although all the current building is in existing ones.

Finally, a brouhaha erupted after Israeli journalists began asking Palestinian negotiators whether they would recognise Israel as a Jewish state. They refused. Such recognition means, in effect, renouncing the Palestinian refugees' claim to return to Israel. In theory, they could outnumber Jews if they all came back. Though such a measure will be essential to concluding a peace deal, it would be suicide for a Palestinian leader to concede it in advance. Their refusal stung Mr Olmert into saying that such recognition was “not subject to either negotiations or discussion”, making it look as if he were demanding it as a precondition to peace talks—though Israeli officials say it will not be.

Ms Rice shuttled and shuttled, but could not stop Israel from repeatedly raising the bar. For his part, Mr Abbas, having threatened to pull out of Annapolis if it proved to be devoid of content, turned out not to have the guts—no doubt fearing a withdrawal of American support for his precarious regime.

Close to midnight

Mr Olmert still wants a final-status agreement within a year, he said this week. But the drive towards the summit has encouraged rightists in his coalition to throw up new obstacles to talks. The religious Shas party connived with the opposition Likud to pass the first reading of a bill requiring that a division of Jerusalem, which any reasonable peace deal would entail, be approved by an almost unattainable two-thirds majority of legislators. Avigdor Lieberman of the secular-nationalist Yisrael Beiteinu party claims the credit for prodding Mr Olmert to demand recognition of Israel as a Jewish state and also for the demand that any final deal be implemented only after the first stage of the road map.

That is a good cause for worry. The road map originally attempted to take the best elements from previous failed peace plans. It stipulated confidence-building measures first, as in the Oslo accords of the 1990s, but on a shorter timetable; and followed them with a series of final-status negotiations, rather than attempting to resolve all the issues in one marathon session as the Camp David talks in 2000 had tried to do. But plans for an independent arbitrator for the road map were never realised. That allowed Israel, as the stronger party, to be the judge of what constituted progress.

A test of the Palestinians' end of the bargain in the West Bank city of Nablus this month highlights why the plan never worked. Though Israel allowed the PA to deploy up to 500 police in the city, its own army continues to invade the refugee camps in search of wanted men during the nights. This undermines public support for the experiment—and the police are not allowed to chase suspects outside the city limits. The PA complains that its forces cannot become effective against militants unless Israel lets them operate unhampered in the West Bank; but Israeli politicians cannot afford this because of the attacks that Israel would suffer in the interim until the PA forces become effective.

To make things worse, Ehud Barak, leader of the Labour Party, who as Mr Olmert's defence minister is the man who carries out the Israeli side of the road map, has been trying to boost his future prime-ministerial chances by looking even tougher than Mr Olmert on security. Indeed, one reason why Mr Olmert chose to go back to the road map he so deprecated may have been to wrong-foot his chief rival by making him look like an obstacle to peace. It worked—Mr Barak's tough line reportedly disconcerted the Americans—but showed just how much domestic politics can enfoul the peace process.

Another element still being debated in the run-up to Annapolis, therefore, was a mechanism to monitor the road map's implementation. The Palestinians wanted it to be tripartite; Israel wanted it to be American-only, and non-binding.

There is one upside to all this: final-status talks may indeed begin for the first time in seven years. But the scramble to make Annapolis happen has thrown up new obstacles to those talks. And some critics wonder what sense there is negotiating a peace deal if it may then have to be shelved because the first stage of the road map has not been fulfilled.

Not even a glass slipper

So what next? It is worth recalling that the original point of Annapolis was to strengthen Mr Abbas. Mr Bush convened the meeting in July after the showdown in Gaza a month earlier between the security forces loyal to Mr Abbas's Fatah party and those of Hamas. Though the Islamist movement won the PA elections last year, Fatah had never conceded control of the PA's forces, and Hamas had formed its own “Executive Force” in Gaza in response. After months of clashes, Hamas routed Fatah and took control of the strip. Mr Abbas fired the Hamas government and appointed an interim one in the West Bank, but Gaza was lost.

In this division of Palestinian territory, America saw an opportunity. It had led a Western embargo on aid to the PA since the election. Now, with Hamas confined to Gaza and Mr Abbas back in charge of the West Bank, American officials reasoned that a policy which improved life in the West Bank while making it miserable in Gaza might encourage Palestinians to choose Mr Abbas's way over Hamas's.

To that end, Israel has kept its border crossings to Gaza closed to all but essential humanitarian aid (getting into many disputes with aid agencies as it blocked things they considered essential—such as paper for school textbooks and piping for sewage systems—but which it feared could be used by militants). Tony Blair, the envoy from the “Quartet” of America, Russia, the EU and the UN, is supervising plans to build up the PA, particularly its security forces, and the economy in the West Bank.

Talks on statehood between Mr Abbas and Mr Olmert would be an additional, perhaps crucial, way of boosting Mr Abbas: they would give the Palestinians what Ms Rice likes to call a “political horizon”. But the Annapolis fiasco has made the political horizon hazy. Without a vision of where they are heading, final-status talks could also all too easily fall victim to the same death by a thousand political cuts.

This puts more pressure on the other two parts of the strategy to help Mr Abbas: squeezing Gaza and promoting the West Bank. However, both are weak. The closure of Gaza has certainly made Fatah more popular. One polling firm, Near East Consulting, found this month that Fatah now enjoys a 46% rating against 13% for Hamas, compared to 32% and 17% in June. Fatah's yellow flags are returning to the Gaza Strip's neighbourhoods in ever greater numbers, and many Gazans were no doubt horrified when Hamas men shot dead seven people at a rally in memory of Yasser Arafat, Mr Abbas's predecessor, this month.

Foreign diplomats have seized on this as evidence that the tide in Gaza could be turning. But where would people turn? Hamas runs the show and has most of the guns. There is nowhere for an overthrow to come from—unless Israel is willing to send in the army to do it, at a massive cost in lives. And while some Gazans are feeling the economic pinch, many others were either subsisting on handouts already or

have learned to benefit from a burgeoning black economy, fuelled by a proliferation of smuggling tunnels under the border with Egypt. If and when Gaza is allowed back into polite society, recreating a real economy will be a back-breaking job.

And what about the ugly sisters?

Meanwhile, there are ambitious plans for the West Bank. Salam Fayyad, Mr Abbas's prime minister, wants to rebuild eight headquarters buildings for the PA's security forces destroyed by Israel during the last *intifada*. Mr Blair, mediating between him and Israel, has got a series of development projects unstuck. At their annual meeting in December, the PA's foreign donors will review plans and, or so Mr Fayyad hopes, pledge large sums.

Yet the PA itself is facing large budget deficits next year. Having thrown billions of dollars at the PA since its inception in 1993, donors are chary of giving more before Mr Fayyad slashes the bloated payroll—politically difficult, since previous governments have let it become a sponge for unemployment. Other donors think it will be just as wasteful to pay for development projects until Israel removes more of the nearly 600 checkpoints and barriers within the West Bank. Israel promised to remove 24 such obstacles during its talks with Mr Abbas, but it has been nickel-and-diming him: according to Machsom (Checkpoint) Watch, an Israeli group, the army in fact took down only two barriers, and many of those it reported removing did not even exist.

Does it really matter if Annapolis gives the peace process only a feeble push? Again, that depends on whom you talk to. Some hoped that the summit would kick off a new Middle Eastern grand bargain. Saudi Arabia, which had drafted the first version of the 2002 Arab League initiative calling for "normalisation" with Israel in the event of a full peace accord, would attend, giving Annapolis its imprimatur and encouraging the Arab League to make its demands a little more flexible for Israel. Syria's presence would mark a first step to a Syrian-Israeli peace—and to breaking Syria's alliances with Iran, Hamas and Lebanon's Hizbullah party. Both Saudi Arabia and Syria were invited but at mid-week Arab countries were still discussing whether to send anyone. It seemed likely that, at best, they would be only low-level.

If instead Mr Abbas comes out of Annapolis looking weaker, says one Arab diplomat, it would add to a deadly regional cocktail. The coming year will see the test of whether Mr Bush's "surge" can save Iraq from meltdown. Whether Lebanon soon slides into another civil war may hang on the outcome of a presidential election this week. Both countries are ripe breeding grounds for jihadists. And if the PA's authority deteriorates in the West Bank, the jihadists, who have never thrived where the comparatively moderate and nationalist Islamism of Hamas held sway, could grow stronger there too.

A less alarmist view is that Israel and Palestine could potter along as they are now for a long time. As it gradually shuts off the West Bank behind a barrier, Israel seems to have learned how to thwart most Palestinian attacks and to live in relative calm. Meanwhile the world's collective guilt may guarantee the Palestinians life-support in perpetuity.

But as they potter, compromise grows harder. The Israeli public is ever more distrustful of the Palestinians and it is taking the political system with it. Any aspiring prime minister, such as Mr Barak, has at least to look as if he were giving the Palestinians nothing.

On the Palestinian side, Mr Abbas has resisted pressure to weed out corrupt timeservers in Fatah, an essential step to making the party electable again. An already not-so-young new generation of Fatah leaders has become disillusioned after years in waiting. "Fatah reform is making progress," jokes one of them, "the old guard is getting older." Mr Abbas's political loyalties could also put him at odds with Mr Fayyad's need to slim down the PA bureaucracy. And though PA forces in the West Bank, with Western support, can keep a repressive lid on Hamas and other groups for quite some time, an extremist backlash will one day be inevitable.

However, nobody seems ready to deal with Hamas. Palestinians voted it into power in January 2006 partly out of frustration at Fatah's incompetence, corruption and inability to win them an independent state. Yet polls show that though Hamas refuses to recognise Israel's right to exist indefinitely—when in power it offered a multi-decade truce instead—most Palestinians still believe in a permanent two-state deal.

A few in the Israeli establishment therefore argued privately for holding talks with Hamas, on the

grounds that Palestinian public pressure would eventually turn a long-term peace into a permanent one. But most rejected that approach.

So did America and its Arab allies, which fear that Hamas, an offshoot of the Egyptian Muslim Brotherhood, could set a precedent for Islamists in Egypt, Jordan and elsewhere to take power from pro-American autocrats across the region. It may be no coincidence that Mr Abrams, now running Middle East policy, was in the vanguard of American policy to prevent a similar, pro-Soviet “domino effect” in Central America in the 1980s.

But since its humiliation in Gaza in June, the biggest opponent of rapprochement with Hamas has been Fatah. Its officials talk of Hamas people as “a different culture” and even “not Palestinian”. One senior Fatah man, who fled Gaza after the Hamas takeover, acknowledges that this divide is fatal for Palestinian aspirations. So long as Mr Abbas represents only the West Bank, outside pressure on Israel to conclude a peace deal with him will be minimal. And yet, he shrugs, “we have no choice.” That seems to sum up eloquently the fate of both Israelis and Palestinians: hostages to their internal politics, above which none has the vision to rise. All the more need for outsiders to step in.

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The candidates: Mike Huckabee

Faith, Hope and populism

Nov 22nd 2007 | WHITEFIELD, NEW HAMPSHIRE AND WASHINGTON, DC
From The Economist print edition

WPN

Is another former governor of Arkansas the answer to conservative prayers?

“THERE are no perfect candidates. We had one 2,000 years ago, but we crucified him,” says John Stemberger, a family-values enthusiast from Florida. That pretty much captures the mood among socially conservative voters. If you think abortion on demand is a holocaust and gay marriage threatens to undermine the conventional sort, you are unlikely to back a Democrat. On the other hand, none of the leading Republicans thrills the religious right either.

Rudy Giuliani is pro-choice on abortion. Fred Thompson lacks gumption. Mitt Romney is a Mormon. John McCain tells a moving story of his time being tortured by godless communists: one of his Vietnamese guards secretly loosened the ropes that trussed him and, by way of explanation, drew a cross in the dirt with his foot. But Mr McCain has long riled religious conservatives, once calling the late televangelist Jerry Falwell an “agent of intolerance”.

Enter Mike Huckabee. A couple of months ago, few people had heard of him outside his native Arkansas, where he was governor. This week a poll put him a close second among Republicans in Iowa, the crucial first-voting state. He came within four points of the leader, Mr Romney, and has trebled his support since July, leaping from 8% to 24%. Twice as many evangelical Protestants in Iowa backed Mr Huckabee as backed Mr Romney, with the rest of the field nowhere. Pundits now have to take Mr Huckabee seriously.

His core appeal is to “values voters”, as they sometimes call themselves. Pro-lifers and evangelical Protestants immediately sense that he is one of them. He is a Baptist minister. He can cram eight Bible stories into a single paragraph. He can say things like “it's important that the language of Zion is a mother tongue and not a recently acquired second language” without it sounding contrived. (Pious audiences know this is a dig at Mr Romney, who only became pro-life when he was thinking of running for president.) He can even link abortion with illegal immigration: would America need to import so many workers if it hadn't let multitudes die in the womb?

If social conservatives were to coalesce around Mr Huckabee, that would throw the Republican primaries into utter confusion. The candidate they back tends to win the Republican nomination. Their record turnout in 2004 helped George Bush beat John Kerry. Yet social conservatives are only a small minority of the national electorate, so they have to pick a candidate who also appeals to others. Some think that Mr Huckabee might be that candidate.

Largely, this is because of his personality. On the campaign trail, he is approachable, chummy and eloquent. He talks about hunting. He plays the bass guitar with school bands. He plays up his endorsement by a bearded action-movie star: “My plan to secure the border? Two words: Chuck Norris.” As the son of a fireman and the first man in his family to finish high school, Mr Huckabee embodies the American dream in a way that Mr Romney, the big-businessman-turned-governor son of a big-businessman-turned-governor, cannot hope to.

He cracks corny jokes. He admits they are corny, yet crowds love them. On a recent stop in New Hampshire, he suggested that Jesus doesn't approve of air travel. “He said: ‘Lo, I am with you always.’ But He said nothing about up high.”

Another man from Hope

Like Bill Clinton, he hails from Hope, Arkansas. (“Give Hope a second chance,” he quips.) Also like Mr Clinton, he has humanising flaws. He was once colossally fat. Feeling unwell, he asked his doctor what the problem was. “You're fat,” said the doctor. Mr Huckabee said he wanted a second opinion. “OK, you're ugly, too,” came the reply. Mr Huckabee got a grip, lost 100lb (45kg) and now runs marathons. He wrote a diet book: “Quit Digging Your Grave with a Knife and Fork”. At a dinner in New Hampshire, he offered your correspondent his sticky pudding.

Many voters find this appealing. Values voters, typically poorer and less well-educated than other Republicans, sense a kindred spirit. Heck, plenty of Americans can relate to a man who has wrestled with extra rolls. Plenty applaud a candidate who seems so straightforward, too. In a poll by YouGov/Polimetrix for *The Economist* (full results here), Republicans rated him the most honest candidate and Americans rated him the most moral of either party (see chart: Hillary Clinton was rated the least honest, and, after Mr Giuliani, the least moral).

***The Economist*/YouGov poll**

What qualities do you associate with the following candidates, %

	Honesty	Intelligence	Competence	Reliability	Strong leadership	Good judgment	Morality
Giuliani *(R)*	26	51	46	35	53	30	15
Thompson *(R)*	33	45	35	24	22	24	29
McCain *(R)*	38	54	45	32	35	22	36
Romney *(R)*	28	51	40	24	28	24	39
Huckabee *(R)*	42	43	39	28	22	25	46
Clinton *(D)*	19	61	44	25	40	24	19
Obama *(D)*	38	65	40	26	29	26	35
Edwards *(D)*	32	55	39	24	24	26	32

Full poll details are available at www.economist.com/YouGov

Mr Huckabee's weakness is the worry that he may be a lightweight figuratively as well as literally. It is fine for his 12-step weight-loss plan to be simple. “Eat less and exercise more” is good advice. But his 12-step plan to “restore America's greatness” is worryingly populist.

Take trade. Mr Huckabee calls himself a free-trader, but on the stump he does not sound like one. He rouses nativist crowds by fretting that America cannot be secure unless it is self-sufficient in food, energy and military hardware. “I don't want to see our food come from China, our oil come from Saudi Arabia and our manufacturing come from Europe and Asia,” he says. “There is so much foolishness in that one sentence it is hard to unpack,” comments Rich Lowry, a conservative columnist. America hardly imports any food from China. Mr Huckabee's promise of energy independence within 10 years is impossible. And cheap imports benefit precisely the cash-strapped folk Mr Huckabee purports to champion.

Mr Huckabee's tax plan is as radical as it is ill-thought out. To achieve a populist goal—abolishing income tax—he proposes a federal sales tax. To make up for lost revenue, it would have to be a stiff one, and levied on practically everything. Mr Huckabee says a rate of 23% would suffice, but this is a sleight of hand. Calculated the way sales taxes usually are, the rate would have to be at least 30% and possibly much higher. This would be horribly regressive. Mr Huckabee says he can solve that problem by giving monthly rebate cheques to those who need them. But to track Americans' income month by month would

require a bureaucracy nearly as intrusive as the one Mr Huckabee hopes to abolish by repealing the income tax. The plan is a non-starter.

On green issues, he is all mood and little substance. He says God wants us to look after the earth, and touts his own use of a flex-fuel car. But he has no serious plan to reduce greenhouse gases. A carbon tax, he claims, sounds too much like a tax. And a cap-and-trade system sounds “a bit like buying indulgences from the ancient church,” he told the *Wall Street Journal*.

Mr Huckabee's ideas on health care are considerably sounder, and he sells them deftly. He understands that costs are out of control. “We have to change a system that happily pays $30,000 for a diabetic to have his foot amputated, but won't pay for the shoes that would save his foot,” he says. He warns, wisely, of the looming budgetary calamity when baby-boomers start claiming Medicare (public health care for the elderly). Or as he puts it: when “all the old hippies find out that they get free drugs.” He touts the benefits of prevention, citing his own life-saving weight loss as an example.

Weighed in the balance

Overall, though, Mr Huckabee is a less rounded candidate than his chief rivals. He has little or no experience of foreign policy. His support among self-described moderate Republican voters in Iowa is negligible. He was not a bad governor of Arkansas—he fixed up the state's roads and schools. But his success was hardly as dramatic as Mr Giuliani's in New York, nor has he anything like Mr Romney's breadth of executive experience. The website for the Council on Foreign Relations, a New York-based think-tank, lists the various candidates' positions on a range of foreign-policy areas: on an embarrassing number of them, including defence, North Korea, Africa and India, Mr Huckabee's position is listed as “unknown”.

And as people start to take Mr Huckabee's presidential bid seriously, he will face the sort of hostile scrutiny he has so far mostly avoided. The Club for Growth, a lobby for economic conservatives, assails him for hiking sales and petrol taxes in Arkansas, and for his attacks on industries he accused of “price-gouging”. The Club says that nominating him would be “an abject rejection” of the free-market, limited-government principles for which the Republican Party stands. The Cato Institute, a libertarian think-tank, gave him a “D” grade for fiscal policy. Salon.com, an online journal, recently published a long list of ethical complaints about Mr Huckabee compiled by a reporter from Arkansas.

Nationally, voters still think Mr Huckabee likeable and godly. That is probably not enough to win him the Republican nomination. But he might easily peel enough values voters away from Mr Romney to hand the race to Mr Giuliani, which might in turn prompt pro-lifers to support a third-party candidate in the general election. With five candidates still very much in the frame and no one convincingly ahead, the Republican primaries will certainly not be dull.

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New Hampshire

Cannon to the north of them

Nov 22nd 2007 | CONCORD AND MANCHESTER
From The Economist print edition

One of America's smallest states is packing a big punch

COULD a tiny sliver of land, home to less than a half-percent of America's population once again hold the key to next year's presidential election? Conceivably, yes. New Hampshire, which will host the first of America's primaries on January 8th next year, may play a crucial role in deciding whether the current front-runners, Hillary Clinton for the Democrats and Rudy Giuliani for the Republicans, secure their parties' nominations. Which is not how things were meant to be.

No fewer than 21 states have elected to hold primaries or caucuses on February 5th, a sort of “mega-Tuesday” whose effect will far outweigh the importance of the smaller, and later, “super-Tuesday” in previous elections. Their aim was to diminish the disproportionate influence of New Hampshire's primary and Iowa's caucus, currently set to start the whole process off on January 3rd. But most analysts reckon that the result has been exactly the reverse: Iowa and New Hampshire, just five days apart, seem more influential than ever. The 16 current candidates plainly think so; they have collectively held no fewer than 2,500 campaign events in the two states since the beginning of this year, more than in all the other 48 states put together.

Iowa still matters most, which is why Mrs Clinton, for instance, has appeared there 106 times this year, compared with 57 for New Hampshire, reckons the *Washington Post*. But huge attention is being paid to New Hampshire too. In many ways it is a more interesting contest. Because it is physically much smaller than Iowa, and its population is concentrated around the old mill-towns of the south, like Manchester and Nashua, “retail politics” there is even more up-close and personal than in Iowa. Its well-educated and well-off citizens have plenty of opportunities to crowd into school gymnasiums, diners and church halls to hear and to interrogate.

And, above all, the state likes to vote: it chooses its governor every two years, and turnout for the presidential primaries will be of the order of 65%, compared with around 10% for Iowa's caucuses. Well over half the electorate consists of voters of undeclared allegiance, though the state has been trending Democrat for years, thanks to an influx of liberal east-coast retirees drawn to its lakes and mountains and yuppies working in its booming tech sector. New Hampshire gives a good indication of how a candidate appeals to independent voters, the largest group in the country.

New Hampshire looks likely to matter most to the Republican race, where it will probably either make or break Mr Giuliani. Until recently, the former mayor of New York had been engaged in a breathtakingly bold strategy: to ignore the early states (which also include Michigan, due to vote on January 15th, and Nevada and South Carolina, both due on January 19th), in favour of concentrating on Florida (January 29th) and the February 5th states.

But there is a snag. Mitt Romney, a successful businessman and former governor of Massachusetts, has been spending vast amounts of his fortune in Iowa and New Hampshire, and leads the polls in both of them. Throw in the fact that conservative South Carolina might not take to a man currently on his third wife and that Mr Romney's father was a popular governor of Michigan, and there is a real chance that Mr Giuliani might end up heading to Florida having lost four races to his main rival.

So Mr Giuliani now hopes to break Mr Romney's challenge in New Hampshire, and is campaigning hard there. He has a chance. New Hampshire voters care little for conservative social obsessions: the state, dominated by Republicans until last year, allows gay civil unions. Even when it had a Republican governor and solid Republican majorities in its state legislature, it never got close to restricting abortion.

Mr Giuliani's mix of fiscal conservatism and social liberalism is a good fit for a state whose motto is “live free or die”—and which, appropriately, has no helmet requirement for motorcyclists or seat-belt requirement for anyone over 12. But he has left it late: Mr Romney has been campaigning hard since

April and has a far better team. If there is a Romney bandwagon, New Hampshire will be where it starts to roll. The state may also mark the end of John McCain's presidential hopes—or, just possibly, the start of a revival.

On the Democratic side, the analysis is different. Mrs Clinton is comfortably ahead, and has assembled by far the strongest machine. Running as a centrist also helps her in New Hampshire with its high turnout: she may be better placed to lure over independent voters than is Barack Obama, her chief rival.

That said, her margin over Mr Obama in New Hampshire is less comfortable than her national lead: around 14% compared with 20%. In Iowa her lead has almost vanished. The most recent poll shows Mr Obama slightly ahead. Were he to score an upset victory in Iowa, Mrs Clinton's New Hampshire edge would melt away like an icicle in spring. And if he then won in New Hampshire, the entire election might be stood on its head; the large black vote in South Carolina might, for instance, radically reassess his electability.

It has happened before. Howard Dean was streets ahead in November 2003, and John Kerry was polling around 7% nationally. But Mr Kerry unexpectedly won in Iowa, thumped Mr Dean in New Hampshire and went on to take the nomination. Small wonder that New Hampshire's citizens are getting their fill.

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The campaign trail

Primary colour

Nov 22nd 2007
From The Economist print edition

For sale
A poll of New York University students revealed that 20% would give up their vote in the next election for an iPod and two-thirds would do so for a year's college tuition. Half would renounce their vote permanently for $1m.

Washington Square News, November 14th

Invisible man
“Oh no, no, no, no. Don't do it, no. Don't make me speak.”

Senator Joe Biden on finally being allowed to speak 15 minutes into the Democratic candidate debate in Las Vegas, November 15th

Popularity contest
“Yes, I've made a lot of people angry. But I didn't go to Washington to win the Mr Congeniality award.”

John McCain defends his reputation. He also said this week that he will reject Secret Service protection if he wins the nomination. Associated Press, November 18th

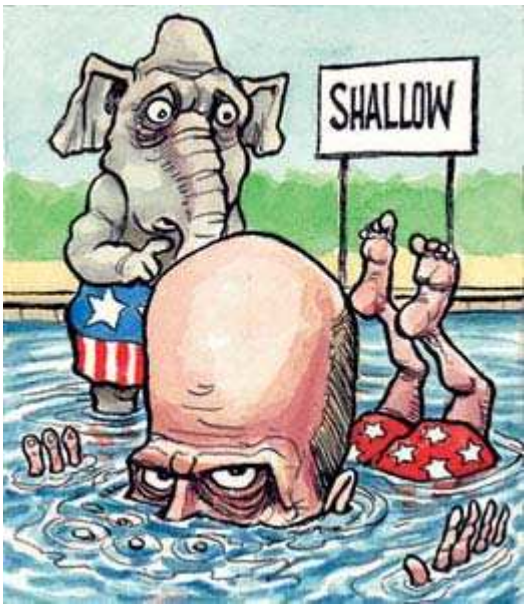
Suck-up of the week
“This is a quintessentially American sport. It represents the best of America.”

Rudy Giuliani, opera fan, panders to NASCAR supporters in Florida, *Washington Post*, November 19th

Endorsement of the week
“I support Dennis Kucinich because not only have I been a friend of his for 40 years, but I believe he offers an essential, viable and exciting option to the candidates that are more popular.”

Larry Flynt, a pornographer, announces his eagerly awaited endorsement. Xbiz.com, November 16th

Illustration by Kevin Kallaugher



Sinking ship
“I think he's kind of done a belly flop.” Anonymous congressman on his disappointment with Fred Thompson's campaign. CQ Today, November 19th

Miss Manners
“Excuse me, were you invited to speak here this afternoon?”

Hillary Clinton responds inimitably to a Code Pink anti-war heckler in Los Angeles. MyFoxLA.com, November 18th

Love / hate
An Associated Press poll reveals that Hillary Clinton is the candidate whom voters would most like to have on their bowling team and also would most like to take on their family vacation. Unfortunately Mrs Clinton also comes top as the least desirable candidate on both a bowling team and holiday.

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Corruption

Remembrance of things past

Nov 22nd 2007 | WASHINGTON, DC
From The Economist print edition

Corruption strikes the capital again

IN THE mid-1990s the city government in Washington, DC, was so mismanaged and wasteful that Congress humiliatingly imposed a federal control board on the district. Since then, however, Washington has had a string of far more impressive leaders who have put an end to years of emigration and have improved the city's bond rating from junk status to A-plus.

Until recently, Natwar Gandhi, the District's meticulous chief financial officer, exemplified Washington's new management. Mr Gandhi, whom the *Washingtonian* dubbed “Dr No”, rationalised the city's tax collection and its spending after Marion Barry, a four-term former mayor (and drug convict), had debauched the municipal exchequer. The district ran a $325m surplus in 2006.

But elements of the old Washington persist: the most expensive corruption scandal in the city's history may now even bring down the revered Mr Gandhi. Earlier this month, federal investigators arrested two middle managers from the DC Office of Tax and Revenue—a division Mr Gandhi used to run and still presides over—on charges that they stole $16m by means of fake tax refunds from the District government. After subsequent inquiries, officials now say the total is closer to $30m.

The abuse was often flagrant. According to the *Washington Post*, civil servants forged paperwork and authorised refund cheques to fake companies—including the aptly titled Bilkemor LLC. Federal authorities estimate that these payments averaged around $380,000 each. By contrast, legitimate refund cheques average between $10,000 and $17,000.

The alleged ringleader of the scam, Harriette Walters, was known as “Mother Harriette”. She showered her co-workers with gifts and is said to have provided her superiors with loans. An FBI inventory of items confiscated at her house reflects the tastes of an Imelda Marcos. The Feds seized 47 Chanel purses and 43 other bags, 100 pieces of jewellery, including ruby and diamond necklaces, 68 pairs of shoes, a pair of silver-plated iguana figurines and a “Fabergé egg”. They found a $160,000 Bentley in her brother's garage and property in Washington, DC, and New Jersey.

Ms Walters and her alleged co-conspirators are now awaiting trial. But the fate of Mr Gandhi is not yet clear. He has fired 15 tax-office employees and launched a top-to-bottom investigation of the division. He is also declining to resign, even as pressure mounts for him to do so. A *Washington Post* investigation has found that during the period when Mr Gandhi headed the tax office at least $2.4m in suspect cheques were authorised. The city's auditor has also said that she warned Mr Gandhi of irregularities in property-tax refunds as early as 2004. Multiple local investigations are now underway and a Virginian congressman, Thomas Davis, has asked the Government Accountability Office to audit the district's tax outfit.

Whether Mr Gandhi will be able to stay may well depend on the results of these probes. Whatever happens, though, Washington's taxpayers are unlikely to get anything like all of their money back: only $6.5m in cash and property has been accounted for so far.

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Barnyard externalities

The hunt for the odourless pig

Nov 22nd 2007 | CARROLL COUNTY
From The Economist print edition

Regulating America's big farms

IN TWO long buildings in Carroll county, Indiana, some 8,000 pigs are doing what they do best: eating, defecating and squealing. Cute, they are. Tasty, they will be. But livestock operations like this one are increasingly under scrutiny. Above the pigs' heads are instruments measuring dust and noxious fumes. Farther east, in Randolph county, the local planning commission will vote next month on whether to limit the expansion of pig farms.

As America's pig, cattle and poultry farms have become bigger and more efficient, so have fears of the effect on their surroundings. Some 450,000 of America's 1.3m livestock farms qualify as “confined feeding operations” (a poultry farm, for example, with more than 30,000 hens). About 19,000 farms are designated as “concentrated animal feeding operations”, with more than 100,000 hens, 700 dairy cows or 2,500 pigs. The question is how best to police these enormous flesh generators.

The huge farms have not carried on with total impunity—they have been regulated by the Clean Water Act's permit system for polluters since the 1970s. Last year, however, in response to a court decision, the Environmental Protection Agency (EPA) was forced to limit the number of farms covered by its rules on permits and manure management. Some states are therefore stepping forward to create their own guidelines.

As officials work to set rules, the main concern has been to protect water supplies by dealing with waste properly. But there is another obvious problem: farms stink. The rise of mega-farms and the relentless expansion of America's suburbs mean that residents are encountering the pungent aromas of the countryside as never before—and are starting to sue. Quite apart from the nasal discomfort, the olfactory factor can depress property prices.

To gather proper data and fend off arbitrary penalties under the Clean Air Act and other laws, livestock producers are now paying for a national study of emissions. The study, led by Purdue University, Indiana, and overseen by the EPA, is proceeding well, despite a few hitches. (Pigs in Missouri chewed through some equipment.) Albert Heber, of Purdue, is also looking into ways to lessen the stink—by modifying animal diets, for example, or by biofiltration. To test the technology, he has graduate students sniff samples of smelly air from plastic bags. The able-nosed and strong-willed get $30 a session, and earn it.

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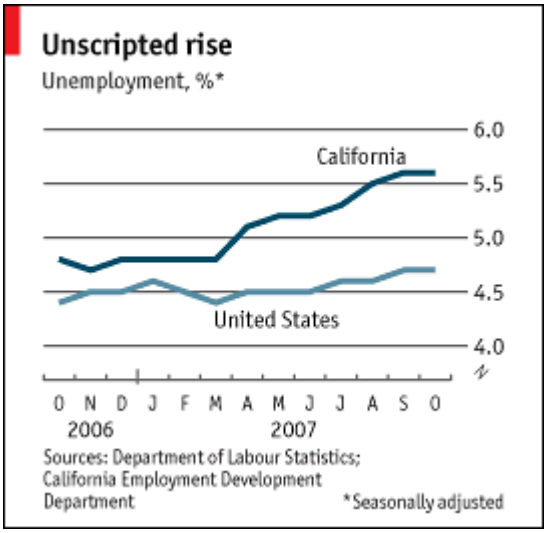
California

Sliding into the sea

Nov 22nd 2007 | LOS ANGELES
From The Economist print edition

The state's economy looks even more wobbly than the rest of America's



THREE weeks after Hollywood's writers switched off their laptops, the picketing continues. Outside Fox studios, red-shirted screenwriters trudge to and fro, carrying signs demanding more money from DVD and internet sales. The occasional car honks in support. It is a strange sight, and not just because a giant poster advertising a new film, “Mr Magorium's Wonder Emporium”, looms over the strikers. This is, after all, one of America's least union-friendly cities. But Los Angeles is coming to resemble a rust-belt town in more than one way. Far beyond the effects of striking writers, its economy is slumping.

In the past year California's unemployment rate—a simple measure of economic health—has jumped from 4.8% to 5.6% (see chart). The national rate has risen, too, but not nearly so steeply. And that mild increase has been largely driven by just one state. Out of every three additions to the ranks of the unemployed in the past year, one was Californian.

Some of this can be blamed on a bump in the number of people entering the labour market, some of them from far afield. As Jack Kyser, a Los Angeles economist, notes, there are a lot of out-of-state number plates on the freeways (and plenty of time to look at them, given the traffic jams). But this higher level of unemployment shows few signs of falling soon. Besides, as John Husing, an economist, points out, some official statistics are too upbeat. In California, about one worker in 11 is illegal, and thus unable to claim unemployment benefit. In some of the industries that have suffered the greatest job losses, the proportion is considerably higher.

One such industry is construction. California's builders, who helped pull the state's economy out of recession a few years ago, now appear to be leading it back. Thanks to stricter lending standards and a glut of properties on the market, house-building has slowed sharply. In September there were just 6,447 housing starts, according to the California Building Industry Association, compared to 21,717 two years earlier. And the units that are being built tend to be relatively modest, which means fewer hands are needed.

Like the climate, the downturn has been relatively mild on the coast. The Los Angeles writers' strike has shuttered late-night talk shows and will almost certainly set back a few drama series. But only a couple of films have been delayed so far. Meanwhile, the wars in Iraq and Afghanistan have been a boon to southern California's defence industry. The Bay Area's technology outfits continue to recover, slowly, from the crash that began in 2001. Demand for housing in San Francisco so exceeds supply that construction has barely slowed. In Santa Cruz, an affluent county south of the city, it has accelerated.

Inland, by contrast, the situation is dismal. Riverside and San Bernardino counties, east of Los Angeles, have grown quickly in the past few years. Between 2000 and 2006 they added an astonishing 770,000 residents. Having created so much construction work, though, they have been hit especially hard by the slowdown. Western Door, a carpentry firm, employed some 450 people in the summer of 2006, according to Steve PonTell, the company's chairman. Despite acquiring another business, it now employs just 150.

The biggest threat to such areas, and to the state's economy as a whole, comes from the American consumer. Southern California is the nation's warehouse: some 40% of all imported goods arrive in the country through the ports of Los Angeles and Long Beach. Since 1991 port traffic has risen steadily, along with consumer spending, though much more rapidly. Between 2005 and 2006 alone it swelled by

13%. The boom has generated many new jobs for truckers and warehouse operators. For the past four months, though, imports through the port of Los Angeles have been down compared to the same period last year. Exports have risen, but not enough to make up the difference. If this trend continues, it will make even a prolonged writers' strike seem inconsequential.

All this has increased speculation about whether the world's eighth-biggest economy is already in recession. That is hard to know, and rather beside the point: economists aside, few are excited by the difference between a mild recession and a period of sluggish growth. In the state capital, though, it certainly feels like a recession. Thanks to lower-than-expected sales and property tax receipts, the state's legislative analyst reckons almost $10 billion needs to be cut from next year's budget. Arnold Schwarzenegger, California's governor, will soon have to explain how to do that. If his solution involves shedding staff, or even hiring fewer of them, that could be bad news for the economy. In the past year government jobs have accounted for almost half of all job growth.

Amid the general misery, one group is oddly cheerful. California's Republicans fought hard for cuts in the state budget this summer, at one point camping overnight in their seats. At the time they seemed like zealots who were trying to use what little power they had to obstruct Mr Schwarzenegger and the Democratic majority. Now they look like seers.

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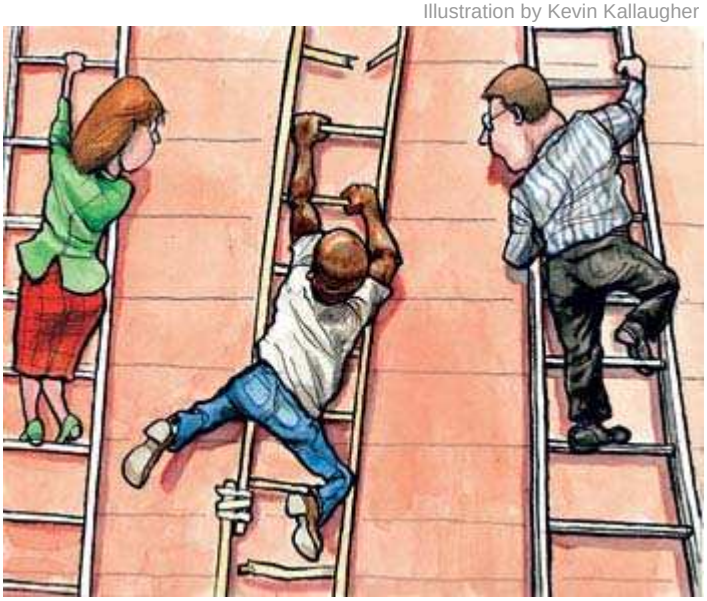
Lexington

The greasy ladder

Nov 22nd 2007
From The Economist print edition

Illustration by Kevin Kallaugher



Middle-income blacks are downwardly mobile. Why?

SOME black Americans are doing very well. Barack Obama is pulling ahead of Hillary Clinton in Iowa. Tiger Woods is the world's best-paid athlete. Stan O'Neal was given a $160m golden parachute as he was ejected from Merrill Lynch last month. But these exceptional folk are indeed exceptional. For members of the black middle class, the news is gloomier. New research suggests that their grip on affluence is precarious.

The Economic Mobility Project, an arm of the impeccably non-partisan Pew Charitable Trusts, compares contemporary Americans' family income (based on surveys conducted between 1996 and 2003) with their parents' (between 1968 and 1972). Overall, the picture is cheerful. Two-thirds of Americans who were children in 1968 and are now in their 30s or 40s enjoy higher household income than their parents did then. The same is true for black Americans. But black upward mobility consists largely of people from poor families moving up. Blacks born halfway up the income ladder, by contrast, show an alarming tendency to fall down. Only 31% of blacks who were children in 1968 and whose parents were in the middle fifth of America's income distribution now earn more than their parents did. The average household income for this group has actually declined—from $53,700 (in 2006 dollars) to $44,900. Nearly half fell all the way into the bottom fifth.

These findings have furrowed many brows. CBS News calls them “chilling”. The *Washington Post* laments that the middle-class dream is eluding African-Americans. Many people find the data perplexing. Why, if America really is the land of opportunity, are so many blacks finding it hard to hold onto the middle rungs of the ladder?

Some caution is in order. Black families who managed to pull themselves up to the middle of the national income distribution by the late 1960s—ie, within five years of the Civil Rights Act—must have been hot stuff. Certainly, they would have been near the top of the income distribution for blacks. So it would not be that odd for their children to fall short of their high standards. Gary Burtless of the Brookings Institution, a think-tank, thinks some of the downward mobility unearthed by the Pew study will turn out to be nothing more sinister than a reversion to the mean. White children whose parents were in the top 20% in the late 1960s have also fallen slightly behind their parents. But nothing like as dramatically as middle-income blacks have. Furthermore, at all income levels, blacks were less likely than whites to surpass their parents. (Overall, blacks and whites were equally likely to be upwardly mobile, but this was

because anyone who starts at the bottom has more room to climb, and more blacks started at the bottom.)

Is racism to blame for downward mobility among middle-class blacks? Probably not much. Discrimination is far from dead, but it is hard to argue that it has intensified since the 1960s. The grease on the ladder must have other ingredients, too. An oft-cited one is the changing structure of the economy. Forty years ago a man with a high school diploma could work at a steel factory for a middle-class salary. Nowadays good jobs typically require a college degree, which black men are less likely than whites to have. Black men who worked full-time in 2004 earned 22% less than white men did, and fewer of them were employed at all.

Another big change since the 1960s is that the black family has all but disintegrated. In 1969 two-thirds of blacks in their 30s were married. Three decades later, 42% were. White families have gone non-nuclear too, but much less dramatically. This affects household income. Other things being equal, two working parents earn more than one. White household incomes have risen sharply in the past generation largely because white women are now far more likely to work outside the home. The richest households typically consist of two professionals, married to each other and working full-time. Few black households look like this. Black women, who have always worked outside the home in large numbers, now earn 95% as much as white women. But they are more likely to be sole breadwinners. And for those who want to marry a black man of similar status, the odds are unkind. For every 100 black female college graduates, there are only 70 black male ones.

Cash is king

A third factor is that even when blacks earn the same as whites, they tend to be less wealthy. In 2000 the average white household in the bottom fifth of income-earners was worth $24,000. For black households the figure was $57—less than Mr O'Neal might spend on lunch. Whites in the middle fifth were five times wealthier than their black counterparts; those in the top fifth were three times more so.

Dalton Conley, a sociology professor at New York University and the author of “Being Black, Living in the Red”, thinks this explains a lot. Extra cash cushions whites against temporary setbacks, such as losing a job or falling sick. It makes it easier to buy a home near a good school, and to borrow money for university. Blacks are less likely to graduate from college than whites with the same family income, but the gap disappears if you compare families with the same income and net worth. Wealthier parents can more easily lend their offspring cash to start a business, and assets mean you can plan for the future.

So what can blacks do to keep their grip on the ladder? Financial education is one big thing, says Dawn Franklin of the National Association for the Advancement of Coloured People. As the recent collapse of the subprime-mortgage market shows, people without assets need to be careful how much they borrow, and on what terms. “Just because a bank says yes to you doesn't mean you got a good deal”, she says.

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Canada's guest workers

Not such a warm welcome

Nov 22nd 2007 | MONTREAL
From The Economist print edition

Illustration by Claudio Munoz

The temporary foreign workers pouring into Canada are often exploited

TIMES had caught up with the sprawling brewery in the town of Barrie, an hour's drive north of Toronto. Canadians were drinking less and less beer, especially the traditional mass-produced brands. So Molson, the biggest of them all, closed the brewery and sold the property. The new owners were soon pandering to a different vice—marijuana. When police raided the plant in 2004, it was producing four crops a year of 30,000 high-grade, hydroponically-grown plants, worth around C$100m ($102m).

Along with the “pot jungles” set up in 40 mammoth brewing tanks, police found a dingy windowless dormitory and living quarters for dozens of workers. The only people charged were nine “gardeners”; the owners escaped prosecution. They may be less lucky next time. The police have launched a new investigation into a bottled-water business they are now running out of the old brewery, involving another fast-growing, but even shadier, area of Canada's economy—the exploitation of temporary foreign workers.

Among the staff at the factory, police found 11 Filipinos, lured to Canada with the promise of jobs paying up to C$23 an hour. Some sold their homes or took out loans to cover C$10,000 or more in fees demanded by labour brokers. But once in Canada, they were “sold” to unscrupulous employers, kept in an isolated rural house, and forced to do menial jobs earning—if paid at all—a fraction of what they were promised. “They were economic slaves,” said a Barrie policeman who chanced upon them: “It turned my stomach.”

The case, still unreported, is just one of a growing number of instances of abuse stemming from the dramatic rise in the use of temporary foreign workers in Canada. The increase is the result of a quiet loosening of restrictions on foreign workers by Stephen Harper's Conservative government, designed, union leaders say, to keep wages low and to avoid a national debate on the sensitive issue of immigration.

It is Canada's thriving economy that is behind the big rise in demand for foreign workers. The jobless rate has fallen to 5.8%, its lowest level in more than 30 years. In provinces such as resource-rich British Columbia and oil-soaked Alberta, the abundance of jobs has actually become a problem; tens of thousands of posts, particularly in the construction and service sectors, remain unfilled.

It is not as if Canada is not already importing foreign workers. Last year more than 250,000 came in,

most of them classified as “economic immigrants”. But they are chosen on a points system which rewards university education and advanced skills. In their countries of origin, many were part of the urban elite. Three-quarters settle in Toronto, Vancouver or Montreal, where there are relatively few job vacancies. Besides, few of these highly qualified immigrants would be interested in pouring cement or coffee for a living.

Heeding the call of employers needing less qualified, lower-paid workers, the government has introduced a series of measures over the past two years designed to make the hiring of foreign workers simpler. No longer are employers obliged to place an advertisement in local newspapers for six weeks for local applicants before searching farther abroad; just one week in a federal job centre will now suffice. Instead of being allowed to stay for only one year, foreign workers are now often getting visas lasting two.

At the same time, the requirement for a “labour market opinion” (LMO) on whether a worker from outside the country is really needed has been scaled back. The federal government has launched a pilot scheme specifically aimed at bringing in low-skilled workers. And special teams of federal bureaucrats have been set up in Calgary, Vancouver and Montreal to help guide employers through the process of hiring foreign workers.

Over the two years to December 2006, these changes contributed to a jump of more than 40,000 in the number of temporary foreign workers in Canada, bringing the total to 166,000. This is sure to be dwarfed by the 2007 figures, when they are released; applications for LMOs (of which about 85% are normally granted) are already up nationally by more than a half since 2006. In Alberta they have more than tripled to over 60,000. “All of this has been allowed to happen without public debate,” Gil McGowan of the Alberta Federation of Labour says. “It was not discussed in Parliament. It was not debated in the last election campaign. It was just done, quietly.”

In the past, Canada's foreign workers have tended to fall into three categories: seasonal agricultural workers; live-in nannies and care-workers; and highly skilled specialists such as academics, entertainers and doctors. But foreign workers are now being sought, too, by small- and medium-sized businesses, particularly fast-food restaurants and hotels, which have trouble both in attracting and retaining local employees. In some of these businesses, anyone who lasts longer than three months is regarded as a “veteran”, says Dan Kelly of the Canadian Federation of Independent Business. Foreign workers are a “massive relief”, not least because they are usually tied to their employer for the duration of their visa.

But Mr McGowan and other labour leaders complain that foreign workers are “now a recruitment tool of first choice rather than last resort”. Once in Canada, they say, there is virtually no monitoring of their pay or work conditions, leaving them wide open to abuse. “Every foreign worker needs basic training in his rights and to be told that there's a place to go to if he's being abused,” says Wayne Peppard, a British Columbia labour leader. Last year his union came to the aid of several dozen Latin American construction workers, who were being paid as little as C$3.56 an hour to dig a tunnel for a rail link between Vancouver and the city airport.

Other foreign workers are both less visible and more difficult to approach. Last spring two Chinese workers were killed when an oil tank they were building in the tar-sands region of northern Alberta collapsed. Housed in a remote camp virtually without any health and safety control, they were part of a crew of 300 workers brought in by a Chinese contractor. When a second tank collapsed soon after the first, the contract was cancelled and the Chinese workers were all sent home.

The reluctance of Canada's opposition parties to pursue the foreign-worker question in Parliament is probably due to a fear of appearing to oppose immigration in a country where one in five of the population are foreign-born. It is a concern that labour leaders share. They are at pains to stress that they do not take issue with foreign workers coming into Canada; they just do not like the temporary aspect of their stay. “If these people are good enough to build our factories and serve us coffee, they're good enough to be full citizens,” Mr McGowan says.

Ottawa is promising to make it easier for temporary workers to become permanent residents, but this is likely to be limited to the more highly skilled. And Canada needs the low-skilled too.

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Foreign investment in Cuba

Bye-bye embargo?

Nov 22nd 2007 | HAVANA
From The Economist print edition

Getting ready for a post-Castro bonanza

THE American businessman at this month's international trade fair in Havana was full of excitement about the communist island's investment prospects as its long-serving president ails. “It's a perfect storm,” he enthused: “Fidel will soon be gone, and a Democratic president will be in the White House. Bye-bye embargo!”

Few of the foreign investors who have spent years struggling to make money in Cuba, caught between American trade restrictions, communist bureaucracy and preferential deals for key allies such as China and Venezuela, see it quite so simply. But even the most jaded are wondering whether things might be looking up. Hopes have been raised by news of a huge deal in the making. It could be the shape of things to come.

After two years of negotiations, plans are moving forward for Dubai Ports World, a partly state-owned company in the United Arab Emirates, to invest $250m in converting the decrepit port in Mariel, just west of Havana, into a modern container facility. A formal feasibility study has been commissioned.

The choice of Mariel, one of the closest points in Cuba to the United States, is significant. The port is best known as the setting for a massive boatlift in 1980 when, over a period of six months, 125,000 Cubans set off in flimsy rafts as Fidel Castro turned a temporary blind eye to those wanting to leave his poor one-party state. They were picked up and taken to the United States by a flotilla of American yachts.

Mariel appeals to international port operators for the same reason—its proximity to the United States. “This deal isn't just about getting goods to Cuba,” said one analyst who had studied the project. “It's about getting into the US market.” American ports are close to capacity, and environmental restrictions make any big expansion of existing terminals unlikely. In a post-embargo world, Mariel, which is expected to be open for business by 2012, would be a well-positioned hub. Goods could be transferred from the big container ships arriving at the port to smaller vessels which could then reach dozens of harbours in the southern United States.

Dubai Ports World refuses to comment on the deal. But there can be little doubt that the company is eager to gain a foothold, if not actually in the United States, then as close as possible to it. Last year it was forced to abandon plans to operate six big ports in the United States after Congress expressed security concerns. Although the United Arab Emirates is considered a close American ally, two of the hijackers involved in the September 11th 2001 terrorist attacks were UAE nationals.

Does Cuba's acceptance of the Mariel project mean that the country's top brass is beginning to plan seriously for the day when the American embargo might end? That might appear premature, given that the Bush administration has explicitly ruled out unrestricted trading with a Cuban government under Raul Castro, Fidel's brother and presumed successor, and that only one American presidential candidate (Chris Dodd, a Democratic outsider) has called for a complete end to the embargo.

All the same, there is evidence that Cuban officials do believe that the days of the *bloqueo* (as they refer to the embargo) are numbered. The Cuban ministries that deal with foreign investment, known by their Orwellian abbreviations of MINVEC and MINFAR, have recently been putting the word out to foreign investors that tenders are welcome for a raft of projects. Theme parks, super-yacht marinas, golf courses, even airlines—all apparently geared to a future American market too—feature prominently on the list.

An end to the embargo could provide a bonanza to investors with assets in Cuba that would appeal to American corporations. The paltry returns from, say, a share in a Havana hotel would be dwarfed by the value that could be realised by selling that stake to an American hotel chain. “That's the game plan,” admitted one Havana-based businessman. “But,” he added, “so is patience.”

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South-East Asia's jamboree

Fifth from the right is the party-pooper

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AP

Welcoming Myanmar's bloodstained prime minister to their summit, ASEAN leaders further undermine their credibility with a toothless new charter

HUMAN-RIGHTS campaigners called for the dictators of Myanmar (Burma) to be uninvited from this week's 40th-anniversary summit of the Association of South-East Asian Nations (ASEAN), following their bloody crackdown on anti-government protests in September. The American Senate unanimously insisted that Myanmar be suspended from the organisation. Needless to say, these demands were ignored. General Thein Sein, Myanmar's prime minister, was instead welcomed as “a family-member” to the party in Singapore.

On November 20th the general and leaders of the other nine member countries signed a new ASEAN charter. This is meant to transform the block into a European Union-style single market by 2015 and guarantee democracy and human rights for the region's 570m people. He had no qualms about signing, for the charter contains little more than waffle. It commits ASEAN's leaders to nothing that matters.

ASEAN had commissioned a group of “eminent persons” to make recommendations on the charter. They concluded that it must provide for sanctions, including possible expulsion, against members who flout the block's principles and ignore its rulings. They also proposed deciding some issues by voting, instead of only by consensus, as now. But ASEAN's leaders shied way from these and other ideas that might have given the charter substance. The text promises a region-wide human-rights body but gives it no teeth. Every time it comes close to sounding tough, it hedges and restates ASEAN's principle of non-interference in members' affairs. The charter says serious non-compliers will be taken to task at future summits. But since culprits will have a veto over any punishment, this is unlikely to be effective.

America's trade representative, Susan Schwab, warned ASEAN's leaders that the block's failure over Myanmar was costing it credibility and would jeopardise a planned trade deal with the United States. But after urging Myanmar to work with the UN to bring democracy, the summiteers backed down at once when General Thein Sein objected to their plan for Ibrahim Gambari, the UN's envoy to Myanmar, to brief them at the summit.

The only leader to show some grit was President Gloria Macapagal Arroyo of the Philippines. She said her Senate might not ratify the charter unless Myanmar made progress on democracy and released its opposition leader, Aung San Suu Kyi. On November 19th Miss Suu Kyi was let out of house arrest in Yangon for a third meeting with the regime's go-between. But two days earlier General Than Shwe, the junta leader, insisted there was no alternative to his “road-map to democracy”—more like a blueprint for keeping the army in power.

ASEAN let in Myanmar ten years ago, arguing that “constructive engagement” would achieve change where the West's sanctions had failed. It has not. Now Myanmar is an embarrassment to other ASEAN members. However, they are resisting tough action over its abuses lest that set an uncomfortable precedent over their own human-rights failings. Singapore banned all outdoor protests during the

summit—a reminder that even the block's most economically advanced member (richer than Spain in terms of national income per head) falls far short of Western standards of liberal democracy.

ASEAN also lags far behind the European Union in economic integration. Its promise of an integrated market for goods, services, capital and labour by 2015 seems fanciful. The eminent persons' report argued that ASEAN must start delivering on such big talk if it is to remain relevant in the face of China's and India's rise. A recent report by the Centre for Strategic and International Studies, an American think-tank, noted that only about 30% of ASEAN's agreements are ever implemented. If a 70% discount has to be applied to everything the region's leaders promise, they should not be surprised if the world regards them as subprime: a risky bet.

Rodolfo Severino, a Filipino former secretary-general of ASEAN, is disappointed that the charter maintains the principle of equal contributions. ASEAN's meagre central budget thus remains constrained by the limited means of Laos, its poorest member. The eminent persons called for EU-style cash transfers from rich to poor members, to accelerate integration. This too was ignored.

ASEAN has some achievements to its credit. It has made war between member states seem unlikely—though gunboats are still sometimes dispatched in diplomatic tiffs. Trade tariffs between members have been reduced substantially. But big non-tariff barriers, such as differing technical standards and cumbersome customs procedures, mean that the block falls far from being a genuine free-trade zone. Martin Hutagalung of the US-ASEAN Business Council, representing over 100 of America's biggest firms, says companies investing in South-East Asia still see it as ten separate markets with ten sets of regulations.

Tariff cuts have boosted intra-block commerce. But ASEAN countries still do three-quarters of their trade with non-members. Likewise with investment: a UN study found that in 2005 Thailand's main investment destination was Hong Kong, while Singapore's was mainland China. ASEAN is seeking free-trade agreements with China and India. Yet without creating the integrated market it talks of, it will be outgunned by Asia's rising giants.

One reason for ASEAN's lack of boldness is the absence of any sense of crisis: the region's economy is growing quickly, if more slowly than India's and China's; and foreign investment has risen recently, though India and, especially, China get far more. But without a healthier promises-to-achievements ratio, ASEAN risks losing influence and even relevance.

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Bangladesh's cyclone

The cruel sea

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AP

The unlucky country is battered again by devastating natural disaster

Get article background

THE heinously overcrowded patch of delta that is Bangladesh finds itself in a painful and familiar position. The country is struggling to cope with the aftermath of a natural calamity—in this case cyclonic winds that tore across the southern coastline a week earlier, killing several thousand people. Perhaps only in Bangladesh—the original “basket case” in Henry Kissinger's scornful terminology—would the latest catastrophe be regarded as less than historic.

The magnitude of the disaster is still unclear. The government speaks of destruction on an “unimaginable” scale. It estimates that more than 5m people have been affected. By the middle of the week, as reports of the first deaths from diarrhoea reached Dhaka, supplies had yet to reach large parts of the remote areas on the south-western coast. The Bangladeshi Red Cross says the death toll could climb to 10,000.

Bangladesh has launched an emergency appeal. Saudi Arabia alone has already promised $100m. The World Bank has said it would provide an additional $250m. But the logistical challenges are daunting. The worst-affected parts of the country—one huge delta—are only accessible by boat or air. The immediate needs are food, clean water and shelter. But an even bigger challenge is long-term rehabilitation. Aid workers say it may take years to rebuild the livelihoods of millions of the world's poorest. The fear is that, habituated to natural disaster in Bangladesh, international attention could soon shift elsewhere.

It could have been worse. A robust cyclone-warning system saved thousands of lives. Some 1.5m people had taken refuge in cyclone shelters when winds of 250km per hour (155mph) and a 5-metre (16-foot) tidal surge hit the coastline after nightfall on November 15th. The economic fallout would also have been much more calamitous if the cyclone had hit one of the country's two main cities, Dhaka and Chittagong. The country's deadliest cyclone, in 1970, whipped up a wave that engulfed Chittagong. At least 300,000 people perished.

The latest calamity will make managing Bangladesh's economy, struggling since the army installed an emergency government in January, even more challenging. An anti-corruption drive, laudable in principle, has seen investment stall and garment exports plummet. Inflation has jumped to a ten-year high. The restoration of democracy looks far-off. An election is scheduled for the end of next year. But with most of the leaders of the country's two main political parties in jail, mostly on charges of corruption, it is hard to see who will contest it. It may well be postponed. Bangladesh would be hard enough to govern even if nature were on its side.

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Indian politics

The real deal?

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Flickers of life in the India-America nuclear deal. Or perhaps death throes

HAD India's leaders set out to portray India not as the rising global power of its imagining but as a chaotic sort of place, unable to maintain a simple policy, much less honour its international agreements, they could not have done better. The government's disarray over one of its proudest achievements—an agreement on civilian nuclear co-operation with America—has stunned its own supporters, as well as George Bush's administration, for which the deal is also a strategic priority.

An unloved creation of Mr Bush and India's prime minister, Manmohan Singh, the deal was unveiled in July 2005. It has since edged its way towards implementation through a suspicious American Congress. But India's Communist parties, who provide crucial support to Mr Singh's government, say they will withdraw that support if Mr Singh proceeds to “operationalise” the deal, by securing the blessing of members of the world's nuclear clubs. This threat forced a dramatic climb-down last month from Mr Singh and Congress's leader, Sonia Gandhi. They said they will not let the government fall over the deal.

It seemed dead. Yet on November 16th its comatose body twitched. At a meeting with the Congress-led ruling coalition, the Communists raised no objection to Mr Singh's starting the blessing process. So this week Indian negotiators met the International Atomic Energy Agency (IAEA) in Vienna. They hoped to agree on a list of “India-specific” safeguards on the use of fissile material in designated civilian reactors. At present no country is allowed to trade nuclear supplies with India, because of its refusal to sign the Nuclear Non-Proliferation Treaty. The co-operation deal would change that. In return, India would submit its civilian nuclear installations to IAEA inspection.

To most neutrals, this looks like a steal for India. It has an urgent need of imported uranium to cope with a worsening energy shortfall. The special treatment that the deal would afford India would confirm its rising status, and cement a growing friendship with America. Yet that is what the Communists object to.

The Communists say they have permitted talks with the IAEA merely to allow the government to fail more gallantly in its efforts to push the deal through; but fail it will. Unpropped by the Communists, the government would almost certainly fall. That would trigger an election that neither Congress nor its coalition allies feel ready for. Congress is already unsure whether Mrs Gandhi's gauche 37-year-old son and presumed successor, Rahul, would be ready to lead the party in an election due by 2009. Before then: no chance.

Yet the government knows the Communists' opposition to the deal has weakened, and that they do not

want an election either. Violence in the Nandigram district of West Bengal, a state ruled by the Communists for 30 years, is the main reason (see article). It pits Communist goons against rival Maoists. This month a dozen peasants are reported to have been killed, and several women raped. Since peasants are the Communists' main base, this is disastrous for them. Worse still, most of the peasants in question—including the raped women—were Muslims. And the Communists had hoped to pick up anti-American votes from Muslims thanks to their opposition to the nuclear deal.

Some government ministers predict that the Communists will continue to resist the deal until it has been transformed, through the blessing of first the IAEA, and then the 45-nation Nuclear Suppliers Group, into an internationally-approved agreement. Then, the ministers say, the Communists will grumblingly accept it in the national interest. Or, at least, they will not pull the rug from under the coalition.

This sounds optimistic. Having sworn to kill the deal, the Communists risk humiliation if it survives. The recent violence has taught them that it may not be the election-winning issue they thought. Yet they may reckon that the need for a consistent ideology outweighs other considerations.

By contrast, Congress, driven not by ideology but by a cult of the Gandhi dynasty, is spared this dilemma—witness the blatant about-turn by its leaders. The fallout has been dreadfully embarrassing. Russia—which wants to flog India four nuclear reactors on the back of the deal—has been openly scornful. Mr Singh may think that by pressing ahead with it, even with little chance of success, he will repair the damage. This would also be optimistic.

Amid so much that is unpredictable, events could yet turn in his favour. An election is due next month in Gujarat, a crucial state for the main opposition Bharatiya Janata Party (BJP). If Congress were to win it, or at least perform well, Mrs Gandhi might feel ready for an election after all. She might then push ahead with the deal and damn the commies. Yet Mrs Gandhi conspicuously spurned a chance to toughen her support for the deal at a Congress shindig on November 17th. And it will be a shock if Gujarat's demagogic BJP chief minister, Narendra Modi, is dislodged. So, the deal may not pass. But a paradox of the current mess is that few doubt that it—perhaps rejigged a bit—will be passed eventually. The task may fall to future governments in Delhi and Washington. If so, the terms can only get worse for India.

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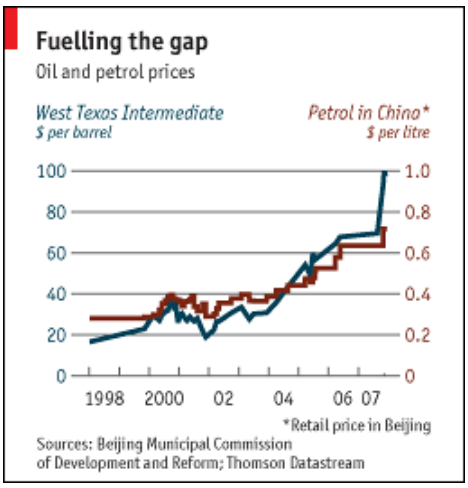
China's fuel-supply crisis

Troubled waters

Nov 22nd 2007 | BEIJING
From The Economist print edition

More oil needs pouring as tensions mount at petrol pumps



EFFORTS to cushion China's citizens from rising oil prices are in disarray. Low government-controlled prices have led to a fuel-supply crisis in many parts of the country. Rationing, long queues, bad tempers and violence have become commonplace at filling stations. Fears of higher inflation are preventing a cure.

Things were supposed to improve after November 1st, when, for the first time in 17 months, the government allowed an increase (of around 10%) in the retail prices of petrol, diesel and kerosene. This was aimed at encouraging state-owned oil firms, whose profits have been threatened by the gap between high crude prices and prices at the pump, to refine more oil and boost supply to consumers. But it has not been enough. This week widespread shortages, which plagued the country two years ago and again in October, have re-emerged (if they ever truly abated).

The state-controlled press, which usually plays down crises, has hinted at the scale of the problem. On November 19th in Anhui province in central China, a lorry driver reportedly stabbed another driver to death in a fight to get to the head of a queue for diesel. Three days earlier, in neighbouring Hubei, a fuel shortage forced public buses to halt, affecting 100,000 commuters. Also this month, rioting erupted at a petrol station in the coastal city of Ningbo. Many places have deployed the police to keep order at pumps.

The severity of shortages varies across the country. Urban Beijing appears unaffected, doubtless to the relief of officials who are acutely sensitive to instability in the capital. But some places are rationing diesel and banning the filling of fuel containers to deter black marketeering. The press says some petrol stations have raised prices beyond state-mandated limits to take advantage of frenzied demand.

In theory, the government has a powerful lever of control. It owns the two oil companies: Sinopec Group (parent of Sinopec Corp, a publicly listed firm) and China National Petroleum Corporation (parent of PetroChina, which is also listed). These firms account for most refining, distribution and fuel sales in China. Their heads are appointed by the Communist Party and hold ministerial rank. If the party tells them to get more fuel to the market, they would be wise to obey, regardless of the cost to their companies.

But it is not so simple. The companies are slaves to the market as well as to the party. Even cash inducements have not worked. In 2005 and 2006 the government gave Sinopec (which depends far more than does PetroChina on crude bought at international prices) subsidies totalling 15 billion yuan ($2 billion) to offset its refining losses. For all their hand-wringing, profits at both companies have been rising this year. But trouble at the pumps could help win more handouts.

The two oil giants stress their eagerness to help. This week they unveiled measures to ease the supply crisis, such as increasing diesel imports and output at refineries. Sinopec said it would delay maintenance work at five refineries and halt exports of refined oil products (“at last”, enthused the *Procuratorial Daily*, a Beijing newspaper, in a commentary accusing “certain people” of using fuel shortages to put pressure on the government).

Freeing state controls over fuel prices would be an even bigger help, say some Chinese academics. But with annual inflation already at a ten-year high of 6.5% the government is wary. Han Xiaoping, a Beijing-based energy consultant, says the government might raise prices again before the end of the year to keep the oil majors happy. It may have to make a habit of it.

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Japanese immigration control

Giving you the finger

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From The Economist print edition

A controversy over fingerprinting foreigners

IN 1641 Japan's shogunate designated an artificial island in Nagasaki harbour as the only place foreigners could live. Japan has of late been more welcoming to *gaijin*. Yet this week it began to photograph and take digital fingerprints of all foreigners entering the country—residents as well as tourists and visiting businessmen. Privacy advocates deplore the emergence of a surveillance state. Pundits say it panders to anti-foreign sentiment in Japan, and undermines the country's ambitions to increase tourism and make Tokyo a global financial centre. Angry expats expect long waits at immigration.

In defence, the government says the measures are simply to keep terrorists out. As an example, Japan's justice minister, Kunio Hatoyama, a butterfly enthusiast, explained that a friend of a lepidopterist friend was an al-Qaeda operative, who for years travelled in and out of Japan on fake passports; the new measures would block the chap. Mr Hatoyama was quickly forced to backtrack lest it appear that ministers run around netting butterflies with terrorists. Yet the truth remains: terrorism in Japan has only ever been home-grown, most recently in 1995, when a sarin gas attack by a religious cult killed 12 in Tokyo's subway.

The system mirrors America's equally controversial US-VISIT programme. In principle, it should not cause such a fuss. All countries are moving towards the collection of “biometric” information: from next year, Britain will collect such data from visa-holders. The problem comes with implementation. America's US-VISIT system is fraught with flaws and cost overruns. Technical problems have delayed Europe's introduction of digital passports. For all Japan's prowess in designing computers, the government is peculiarly inept at running them. This year, it admitted it had lost 50m electronic-pensions records.

Exempt from the new screening are diplomats, children under 16 and certain permanent residents (ethnic Korean and Taiwanese who have lived in the country for generations). Why only *gaijin*? Japan already has all sorts of ways to keep watch on its own people, such as “neighbourhood associations”. Foreigners are outside these social controls. Yet fingerprinting foreigners is just a first step to securing the biometric details of everyone entering and leaving: as it is, frequent travellers, Japanese as well as foreign residents, may save time by pre-registering to use an unmanned automatic gate at airports that takes photographs and fingerprints.

Mr Hatoyama says people should not be delayed more than the 20 minutes it already takes immigration officers to process visitors. This week some of the machines played up, but most travellers fell into line. Officials even claimed to have caught a handful of people who had already been deported at least once. They did not reveal whether they were butterfly collectors.

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China's public holidays

Golden weeks or silver days?

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May Day! Socialism's festival under attack

IT MAY be ruled by the Communist Party, but China has never quite qualified as a workers' paradise. Hundreds of millions of Chinese toil for long hours at low wages, often in dirty and dangerous conditions. Independent labour unions do not exist. But since 1999 working life in China has had one big compensation: a trio of weeklong holidays. Each year—on the May 1st Labour Day, October 1st National Day, and Lunar New Year—most Chinese workers enjoy a “Golden Week” away from the job, though they have to make up for it by working the previous weekend.

That now looks likely to change. The government has mooted reforms that would reduce May Day observance to a single day and distribute the rest over a series of one-day holidays for the traditional Tomb Sweeping day, Dragon Boat festival and Mid-Autumn festival. The number of annual holidays would rise from ten to 11. The change stems partly from practical concerns over the huge stress Golden Weeks place on China's tourist infrastructure. Trains, planes, hotels and tourist areas see a massive crush, turning the break into an ordeal for both holidaymakers and those catering to their needs.

The government has ostentatiously solicited public opinion about the change. In a series of online opinion-surveys and in voluminous press commentary, debate has been surprisingly intense. It has split those who prefer one holiday regime or the other. But it has also covered the government's stated intention of giving new weight to China's own culture, and the relative merits of observing traditional holidays rather than socialism's sacred Labour Day.

Upon the close of the consultation period this month, officials reported strong support for the change. Of 1.3m online voters, state media reported, 88% favoured the increase in total days off, and 62% approved of the shift to scattered one-day breaks. So the decision, due at the end of the year, is likely to back the change. But reform will not stop there. The government also plans to guarantee workers paid holidays to take when they choose. The entitlement would range from five to 15 days annually, depending on seniority. But most workers fear employers would renege on these obligations, and that China's shoddy regulatory system would let them get away with it. It looks like an opportunity for a trade unionist.

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North Korea

Subprime but booming

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From The Economist print edition

Capitalist sprouts in unfertile soil

Ting-I Tsai

Pyongyang's Mayfair

SOME members of North Korea's elite have long drunk the world's most expensive cognac and nibbled caviar. Others in Pyongyang, capital of the world's last Stalinist regime, drive luxury imported cars. Fairness and equality are proudly touted as the hallmarks of North Korea's self-reliant brand of socialism. But with more cash circulating under the country's economic reforms and goods more plentiful, Pyongyang residents are fast becoming consumers. Remarkably, some are also becoming investors in the property market—despite the government's theoretical monopoly on the allocation of housing.

Inspired by neighbouring China, North Korea initiated economic reforms in 2002. Most wage and price controls were dropped and the market was opened to some private commerce. After five years of reform, the new wealth has gravitated mainly to the city's privileged class.

One recent trend is for residents to trade up to bigger, newly built apartments. Under the country's Land Law, passed in 1977, all land belongs to the country and co-operatives, and cannot be bought, sold or even occupied. Yet a North Korean student who studied in China says businessmen are satisfying the demand for up-market housing by obtaining land rights from the local authorities and financing construction with capital from their customers. Chinese experts on North Korea say that the government itself has actually played an active role. Some of its agencies have financed the redevelopment of their properties with capital from their staff. They have then turned a profit by selling the new apartments through the government's housing department.

The student says each apartment covers about 150 square metres (1,600 square feet) and costs as much as $40,000 in the popular Moranbong and Central districts of Pyongyang. Construction is now under way at six or seven sites in the capital's residential areas. The building methods used are outdated, dominated by handmade concrete bricks. A five-storey building can take six months to complete. Because the construction is illegal there are fears that some of the newly built blocks might lose their permits or be confiscated even if they have already been paid for.

Officially, each citizen is entitled to receive 14 square metres of living space. But occupation, rank and “contribution” to the country can make a big difference. A “hero mother” who gives birth to triplets would receive a 200-square-metre home. One 28-year-old woman, who works as a tour guide, boasts of living in the Moranbong district in a 170-square-metre apartment with four bedrooms and two bathrooms, thanks to her father's senior government position. Only married couples are eligible for an apartment from the government, but the guide, who says she is single, claims to be wangling one for herself.

The government probably tolerates privately financed buildings because it is strapped for cash and cannot afford to build housing for its citizens. Many uncompleted, suspended building projects dot Pyongyang's skyline. Cranes gather rust, still perched on top of the buildings. North Koreans hope that foreign capital will help finish the buildings. According to Tigereye62.com, a website covering business in North Korea that is based in China's border city of Dandong, the government is soliciting $50m-60m for Pyongyang's historic Taedong-gang Hotel. The building, where “Dear Leader” Kim Jong Il spent many years with his father, Kim Il Sung, burned down four years ago. The government is also hoping foreign investors will stump up $30m-45m for the partly completed Ryugong Hotel, which was designed to be Asia's tallest, with 105 floors. Construction has been stalled since 1992 because of a lack of funds.

The building mini-boom is good for the tiny cognac-sipping elite. But its members must worry about how the poverty-stricken majority, reared on promises of equality, will react to the sight of their new homes and growing prosperity.

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Cambodia volleyball

Sport returns to Phnom Penh

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From The Economist print edition

One area where Cambodia is ahead of the game

Get article background

MONSOON season in Cambodia brings muddy roads, swollen lakes—and volleyball. The timing is not coincidental. The players are mostly farmers, who have a short respite from their fields then. The game's other distinguishing feature is that its high-flying athletes, who strut their stuff in front of adoring fans, are all disabled. Littered with landmines, Cambodia has no shortage of amputees.

The volleyball league began in 2002 with eight teams. This year it expanded to 16, each supported by a sponsor—an aid agency, a private company or, in one case, an international school. By world standards, it is a bargain: the league's annual budget is around $130,000, for everything. That is less than a day's worth of David Beckham's time.

This year's excitement has not ended with the league play-offs (won by the Phnom Penh Koupreys). From November 24th Cambodia hosts the World Cup for disabled volleyball, its first international sporting event since the 1960s. Reigning champions Canada will compete with other national teams to lift a metal trophy sculpted from melted-down AK-47s. Ranked fourth in the world, Cambodia fancies its chances.

On an overcast afternoon at a weather-beaten outdoor court in Phnom Penh, training is under way. Most players wear made-in-Cambodia prosthetic limbs, a far cry from the high-tech artificial limbs favoured by international athletes. Practice is frenetic. During one volley, the ball hovers above the net for a split second before an airborne player punches it down with his left arm. He turns to slap hands with his whooping teammates. His right arm, which tapers off below the elbow, hangs at his side.

Money is changing the league. Teams lure away top players with sign-on bonuses, including plots of land. Chris Minko, an Australian who helps run the league, says transfer fees are a sign that the league is no longer just a handout. A bigger concern is persuading companies—not just foreign NGOs—to adopt teams. As more investors take a peek at Cambodia's economy—General Electric opened a branch office in July—that, too, may prove just a bounce away.

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Iran

They think they have right on their side

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From The Economist print edition

AP

Why the Iranians see themselves in a very different light

Get article background

IT IS not hard to find examples of the peculiar divergence between how the world looks from Tehran, Iran's capital, and how it looks in the West. Take the recent release of a long-awaited report on Iran's nuclear programme by the International Atomic Energy Agency, the UN's nuclear watchdog. To Iran's state-controlled television, the report showed Iran's innocence and slapped its detractors in the face. In Washington, DC, the focus was on the report's doubts, which appeared to justify a push for further punitive sanctions.

But in many ways, the sparring capitals look more like mirror images than polar opposites. On different scales, both Iranians and Americans tend to take an imperial view. Both governments demonise the other. They use past resentments to reap political rewards by looking tough.

Yet in both America and Iran, currents of dissent are growing, even inside their administrations. In neither case do the dissenters differ much from their leader's stated objective: for Iran it is to claim a perceived right to nuclear technology; for America it is to perform an assumed duty to stop Iran making atomic bombs. In both cases, critics lambast their leaders for tactics that may take their countries to war.

In some respects, those leaders are oddly similar. George Bush and Mahmoud Ahmadinejad are both deeply religious, referring frequently to God's guiding hand. Both are idealists rather than pragmatists, and skilled at folksy populism. Both have replaced dozens of competent officials with like-minded conservatives. And both are now considered, by a large slice of their countrymen, to be bungling and dangerous. The difference is that it has taken Mr Ahmadinejad just two years in power to achieve the unpopularity Mr Bush has gained after six.

There are differences, of course. Mr Bush may be accused of curtailing civil liberties in pursuit of his war on terror. But his government does not drag women off the streets for maladjusting *hijabs*, the obligatory covering of head and shoulders, or jail student activists as dangers to national security or smear political opponents as traitors or muzzle their speech.

On the other hand, Mr Ahmadinejad may be bombastic but he has not implied he may bomb America—and could not, even if he wanted to. Oceans and an unparalleled armoury separate America from any conceivable enemy, except small bands of terrorists. The strategic view from Tehran, by contrast, is of

guns pointing from every direction, at close range, and of potential treachery from within. Only a paranoid fringe in America thinks the country's constitution or the values underpinning it face an imminent threat of being overturned. That fringe is in charge in Iran.

Mr Ahmadinejad's inner circle consists of zealots determined to keep the flame of the 1979 Islamic revolution burning, no matter how much fuel it takes; in fact, it takes a great deal. Of the literal kind, hydrocarbons, Mr Ahmadinejad is lucky to have plenty to burn. For Iran has the world's second-largest reserves of natural gas and third largest of oil. This president's tenure has coincided with surging prices that have pushed Iran's oil income above $50 billion a year. By some counts, it has earned nearly as much under Mr Ahmadinejad as it did in the two four-year terms of his predecessor, Muhammad Khatami.

But to the dismay of Iranian economists, Mr Ahmadinejad has used this windfall to build immediate political capital rather than invest in the future. He has tirelessly toured the provinces, promising massive spending on local projects while maintaining subsidies that, by some estimates, devour a third of the government's budget and account for some 15% of GNP.

Not only has this postponed what many see as vital reforms. The flood of government cash has helped push annual inflation towards 20%. Property prices have risen even faster, sending rents in Tehran beyond the means of new households when the population pyramid's widest tier bulges in the 20-30 age bracket. Property owners have benefited, but sociologists note that the gap between rich and poor yawns as widely as under the hated shah whom the ayatollahs ousted.

Not that wealthy Iranians are very happy either. Businessmen, unlike ordinary citizens, are painfully aware of how international sanctions squeeze the economy and how tougher sanctions could hurt it far more. Until now, traders have generally found ways to keep going. They have switched en masse from Western to East Asian suppliers, such that in a few short years China has replaced Europe as Iran's main trading partner. They have also found ways to skirt the rather effective American pressure on international banks to avoid dealing with Iran, mostly by working through foreign intermediaries, and in non-dollar currencies.

But such means come at increasing expense. One economist reckons that extra charges to open letters of credit via Dubai add 10-20% to the cost of every transaction. Small businesses courier cash back and forth to the Gulf emirate, but should banking strictures tighten, bigger firms would face serious trouble. The local assembler of Peugeot cars, says a consultant, is not going to be able to pay for 100,000 French-made gearboxes in cash.

Government officials try hard to project confidence. They point, for instance, to a boom in house construction and to Iran's success at gaining self-sufficiency in such things as wheat, steel and cement. Petrol rationing, which sparked widespread protest when introduced in June, has, in fact, sharply cut imports. It is true, too, that despite the sanctions imposed by America since the revolution, Iran has enjoyed two decades of steady if unspectacular economic growth. The country seems mildly prosperous compared with its neighbours, with tidy parks, clean streets and impressive figures for schooling and health care.

We don't really need you anyway

Another common official refrain is that the world needs Iran more than Iran needs the world. There is some truth to this. With its 70m consumers, many of them young, Iran is a hugely tempting market. China and India thirst for Iranian energy, while Europe dreams of finding an alternative to dependence on Russia for its gas.

Yet it is hard, hearing tales of bureaucratic hurdles, corruption and Mafia-like interference by such privileged groups as the Revolutionary Guards, and seeing the level of talent displayed by many Iranian entrepreneurs, not to conclude that a country with such rich natural endowments is performing far below its potential.

Iranian analysts debate whether Mr Ahmadinejad's free-spending ways have bolstered or diminished his base of support. Some argue that the rural poor, long disregarded by the urban elite, have directly benefited from state handouts and still warm to his rhetoric of class retribution. Even the middle class, they say, can see for itself the improvements in infrastructure, such as the underground train systems being built in four provincial cities, as well as for the capital. Others note that in local elections last

December, the president's men, who generally fared badly, fared worst in districts where Mr Ahmadinejad previously served in local government. The implication is that those who know him best believe him least.

Iranians grumble openly about the economy. They tend to be less vocal but more worried about Mr Ahmadinejad's other policies. Unbidden, many express dismay at his inflammatory questioning of the Nazi Holocaust, citing this as an example of antics that achieve nothing for Iran. When the mayor of Tehran, Muhammad Qalibaf, a pragmatic conservative, recently called for more “maturity and intelligence” in the handling of foreign affairs, the rumble of approval was almost audible over Tehran's traffic din. His voice joined a chorus that has spread across Iran's complex political spectrum, from the left wing of idealist reformers through the varied hues of conservatism in the centre and up to the margins of the *usulgaran* (fundamentalist) faction, whose radical right wing Mr Ahmadinejad represents.

Yet such criticism has tended to be muted. Iran is no longer as brutal a police state as in the revolution's early years nor even as oppressive as many of its neighbours. Though Iranians bemoan the ineffectiveness of the reformists who dominated the country under his predecessor, Mr Khatami, many do credit them with dispelling the mood of fear that permeated the 1980s and much of the 1990s.

But under Mr Ahmadinejad, selective repression has intensified just enough to signal that open dissent has again grown dangerous. His fellow fundamentalists who dominate such institutions as the judiciary, the state prosecution service and the police have gleefully carried out orders to harass reformist newspapers, stifle student and labour protests, and crack down on “bad *hijab*”, supposedly improper adherence to strict Islamic dress codes.

Their efforts have proved quite effective. Most Iranians probably resist the idea of returning to the supposed Islamic purity of the early revolution, yet most are far too preoccupied with getting by to protest. The *hijab*, even reformists admit, is not much of an issue to the broader public, even though many hate the bullying, hectoring ways by which it is imposed.

Indeed, most Iranians are probably quite proud of their experiment with Islamic-flavoured semi-democracy. Despite the flaws in the system, they tend to respect their institutions. As several young Iranians volunteered to this correspondent, having lived through one revolution, the last thing they want is another.

Knowing the right beards

Besides, Mr Ahmadinejad has had powerful allies. The supreme leader, Ayatollah Ali Khamenei, has directly blessed the fierce morality campaign, and said he considers this the best administration the Islamic Republic has yet seen, though a newspaper close to Mr Khamenei this week accused the president of treating his opponents “immorally”.

Surprisingly to outsiders, who tend to view Iran through the lens of its articulate dissidents, Mr Khamenei remains a revered figure; his office still basks in the shadow of the republic's founding father, Ayatollah Ruhollah Khomeini. Indeed, official portraits of the bearded head of state show a smaller inset of his famously glowering, even more lushly bearded predecessor peering over Mr Khamenei's shoulder.

The supreme leader cultivates an aura of aloofness from mundane affairs, but his backing carries more than moral weight. He directly controls the state broadcasting system and the 125,000-man Revolutionary Guards corps, which mans Iran's borders (so profiting, it is said, from smuggling rackets), liaises with overseas Islamist groups such as Lebanon's Hizbullah and the Palestinians' Hamas, and also runs hundreds of commercial enterprises.

Mr Khamenei is also constitutionally charged with setting the broad foreign-policy agenda. He appoints top judges and half the members of the Guardian's Council, a body of clerics that, among other things, vets candidates for political office. The leader has access to a pool of funds that includes pious donations as well as income from several *bonyads*, holding companies tied to religious foundations.

AFP

Revering the president's favourite mosque

Still, Mr Khamenei, a shrewd arbiter of Iran's bruising politics, has been careful not to allow the president full rein. Crucially, he has refrained from blocking the rise of conservative rivals of Mr Ahmadinejad, such as Hashemi Rafsanjani, a pragmatic former president, in key institutions.

Yet the supreme leader has so far concurred with Mr Ahmadinejad's hard line on one crucial issue, the nuclear file. This may reflect a similar world view: both deeply distrust Western intentions, sense that offence may be Iran's best defence, and feel that Iran is poised to regain its natural place as the region's strongman.

Iran has, after all, so far got away with defying the UN Security Council's order to stop enriching nuclear fuel. But his support on this score for the president also reflects Mr Khamenei's respect for the skill of a populist who has, far better than his rivals, conveyed to the public a link between possession of nuclear technology and a semi-sacred sense of national destiny.

Clever advertising jingles

This is important, because the nuclear programme is not easy to promote. Practically speaking, it makes little sense. Iran has poured an estimated $10 billion into building a complete, home-grown nuclear industry, yet it has just one nuclear power plant, the Russian-built Bushehr reactor, due to come on stream next year. The same money could have built ten conventional plants of the same capacity, fired solely by the natural gas that Iran currently flares off into the sky, because it has not invested in the technology to recover it. Russia has pledged a ten-year supply of fuel for the Bushehr reactor, meaning that there should be no use, any time soon, for the output of Iran's costly nuclear-enrichment plant at Natanz. The purpose of its heavy-water facility at Arak is even more obscure.

Yet the nuclear issue has been successfully portrayed to the Iranian public as a question not of economics but of national pride. Iranians bristle at the suggestion that they may not need nuclear energy. Why, they retort, should they not have it? The sole reason, as Mr Ahmadinejad insists, is that the West wants to keep Iran backward. Most Iranians appear convinced by their government's repeated assertions that the programme is entirely peaceful. Even if Iran produces a nuclear weapon, comes the common retort, so what? Neighbouring Pakistan, far less stable, has them. So does Israel. Those countries have only existed since the 1940s, whereas Iran has been home to a brilliant civilisation since history's beginning. So the rhetoric goes. Given Iran's sense of itself as a thwarted great power, it is easy to see how the issue has grown so touchy.

Yet unease persists among sophisticated Iranians. Even some religious conservatives understand that the nuclear question is not a Manichean one, pitting the good of Iranian progress against the bad of its enemies' ill will. Western countries, led by America, have been inept at explaining that they do not wish to deny nuclear know-how to Iran but simply do not trust its leaders. But the less outspoken opposition

of nearly all Iran's neighbours, as well as of Russia and China (see article), is starting to focus Iranian minds.

The barrage of official praise for the latest report of the UN's nukes-watching agency cannot disguise the fact that it includes some pointed criticisms. True enough, Iran has co-operated pretty much to the letter with the agency. What is missing, the report strongly implies, aside from the required obedience to the Security Council's diktat over nuclear enrichment, is Iran's recognition that it could easily do more to dispel doubts as to its intentions.

It is this point that is starting to cause schisms in Tehran. In a brave move, Shireen Ebadi, a Nobel prize-winning human-rights lawyer, recently called in public for an immediate stop to the enrichment programme. Needless to say, Ms Ebadi is seen as anathema in Iran's ruling circles. Yet her point that Iran would lose little by such a step merely aired in public what more establishment figures say in private. It also served to underline the anxiety generated by another of Mr Ahmadinejad's brash gestures. Following a speech in which he blasted critics of his nuclear policy as traitors, his government announced it would press espionage charges against Hossein Mousavian, who served as Iran's chief nuclear negotiator under Mr Khatami. This, it seems, is what drew this week's sharp rebuke of the president from the supreme leader's camp.

The common explanation in Tehran is that the espionage charge was aimed at tarring the previous administration and reformists in general as dangers to the revolution. Mr Mousavian is known to be close to Mr Rafsanjani—some would say under his protection. Yet this kind of tough domestic politicking also showed up Mr Ahmadinejad's government as dangerously isolated in the world. If there is really nothing to hide about the Iranian nuclear programme, what could there be to spy on?

Mr Ahmadinejad may be correct in judging that, for the time being, he can brazen out his nuclear programme. Most Western countries plainly judge the risks of a military attack on Iran to be greater than its rewards. America is probably beginning to see the advantages of co-operation with Iran in resolving Iraq's woes. But Mr Ahmadinejad is wrong to think that he is home free. The danger of an unwanted outbreak of hostilities, provoked by some chance incident, remains great. Iran will continue to pay a high price, even without toughened sanctions, for its lack of openness on the nuclear issue.

Perhaps most distressing for Mr Ahmadinejad, he is likely to pay a high price in domestic politics for his lack of tact. Assuming there is no American attack on Iran to provoke a nationalist backlash, his radical fundamentalists may well get drubbed in the parliamentary elections in March. In the poll that brought him to power in 2005, some 20m Iranians refrained from voting. Many are itching to get in a word this time. Rather like his nemesis, Mr Bush, Mr Ahmadinejad may find himself facing a punchy parliament packed with people who want to get rid of him.

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Iran's nuclear dossier

Spinning on regardless

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Diplomacy, like inspections, grinds ever more slowly

Get article background

PATIENCE is a virtue, but for how long? Come November, argued Mohamed ElBaradei, boss of the International Atomic Energy Agency, the UN's nuclear guardian, it would be clear if Iran was at last co-operating fully in accounting for its past violations of nuclear safeguards; that would then allow it to build confidence in its claimed peaceful nuclear intentions. Instead the report presented to the agency's 35-nation board on November 22nd says co-operation has been “reactive” at best. Meanwhile Iran forges ahead in defiance of the United Nations with uranium enrichment at its plant at Natanz and the inspectors admit they know less and less of what it is up to. Yet Russia and China are blocking efforts at the UN Security Council to slap new sanctions on Iran.

For Iran, all this is good news. This week its president, Mahmoud Ahmadinejad, called on America and its allies to apologise, claiming inspectors had shown that his country's nuclear activities have been “clean and peaceful”.

The IAEA report tries to accentuate the positive: Iran has provided some extra documentation about past black-market purchases of uranium-spinning centrifuge machines. That said, though, it still denies inspectors access to individuals who could say what such machines, including some more advanced than those spinning at Natanz, have been used for and where.

A controversial work plan agreed by the IAEA in August allows Iran to drip-feed information to inspectors, with new questions addressed only when previous files are closed. Thus the agency still awaits answers on the source of unexplained traces of highly enriched uranium (only the low-enriched stuff is needed for making electricity) and experiments with substances of little civilian use. It also has documents and other information that seem to indicate early military ties to the nuclear programme, as well as high-explosive testing (useful in bomb triggers) and alleged efforts to develop a missile cone that could carry a nuclear warhead.

Iran has pre-emptively dismissed such accusations as “baseless”, so is unlikely to be forthcoming. Nor does it show any sign of suspending either uranium enrichment at Natanz or the construction of plutonium-producing facilities at Arak, as demanded by the UN Security Council. On the contrary, says Mark Fitzpatrick, of the London-based International Institute for Strategic Studies, the pace of enrichment work at Natanz has picked up noticeably, with more centrifuge machines (3,000 by now, in parallel cascades of 164 machines) spinning faster than some experts anticipated.

Of the six countries leading the UN effort, America, Britain and France have pressed for new sanctions; even cautious Germany may be coming round. Russia and China say they want Iran to suspend enrichment. But China this week said it saw room for further talks. Its centrifuges spinning on merrily, Iran will happy to oblige.

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Saudi Arabia

Double indemnity

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A bizarre application of the law

AS CLASSIC film buffs know, a double indemnity is an insurance policy that pays double when the insured person dies in an accident. But in Saudi Arabia, the principle appears to apply to rape victims who have the temerity to appeal, after they have been convicted along with their aggressors.

Last year a 19-year-old woman in the eastern town of Qatif appealed against a sentence of 90 lashes for the crime of *khulwa* (seclusion) with a man who was not related to her. Her lawyer argued that meeting a former friend in a shopping-centre car park, to retrieve a photo of herself that she feared would upset her fiancé, was scarcely so grave an offence. Moreover, this “crime” was far outweighed by the fact that the two friends had been interrupted by seven youths, who abducted them at knife-point and allegedly gang-raped both of them, repeatedly.

An appeals court recently overturned the Qatif judge's ruling, doubling the alleged rapists' sentences to between two and 11 years in jail. But it also more than doubled the rape victims' sentences to 200 lashes, adding six-month jail terms. To add further insult, it barred the woman's lawyer from the court, suspended his licence and referred him to a disciplinary board.

Saudis generally respect their legal system, which is, in theory, wholly based on Islamic principles. Still, certain rulings are increasingly raising questions about the fairness of the 700-odd judges, schooled exclusively in the Wahhabist version of Islamic law, who run it. The Qatif case is only one of many to have raised eyebrows.

Other controversial rulings include one where a judge forcibly divorced a couple because the wife's half-brothers complained she had married beneath her station, another whereby an Egyptian accused of apostasy was beheaded for allegedly putting a Koran in a toilet. In yet another case an Egyptian doctor got 80 lashes for “defamation” after protesting and proving that his son had been sexually molested by his headmaster.

Reforms enacted last month are partly intended to allay public concerns. Most important, they add a third-tier appeals court, with members to be partly appointed by the king rather than chosen by fellow judges. Yet lawyers complain that many judges still consider themselves a law unto themselves. Common practices that breach government rules include ejecting lawyers from courtrooms, peremptorily rejecting evidence or testimony, and barring the public from trials.

The Qatif Girl, as the anonymous rape victim is widely known, is to appeal again. In a society where public shame is the worst affliction, she has already suffered doubly for her bravery in speaking out. One may hope that her next judge will be guided more by basic decency than puritanical zeal.

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African peacekeeping

The doves of war

Nov 22nd 2007 | DJIBOUTI AND NAIROBI
From The Economist print edition

Too many conflicts, too few decent armies to sort them out

Get article background

THE United Nations will juggle nine separate peacekeeping operations across Africa in 2008, including the continent's two largest countries by area, Sudan and Congo. In addition, the African Union (AU) will partner the UN in a new hybrid peacekeeping mission in Sudan's Darfur region. It may also persevere with its own peacekeeping effort in Somalia and in smaller operations elsewhere, such as the Comoros. This sounds impressive. But the UN and the AU are both, in fact, struggling.

The Darfur mission, due to begin in January, is already looking like a lame duck; even 26,000 troops and police are probably too few to deal with the obstructive Sudanese army and fractious rebels in an area the size of France. Worse, the mission lacks basic equipment. The force commander, General Martin Agwai, a Nigerian, wants 40 transport and combat helicopters, all with military pilots. None has been forthcoming. That leaves him in a wretched position. The force can deploy now with virtually no helicopters and risk early humiliation (which would delight the Sudanese government) or it can be ridiculed for failing to deploy on time.

The AU mission to Somalia looks even more forlorn. Military experts reckoned that it would take at least 20,000 troops to impose order on central Somalia. The AU managed to get promises for 8,000. In fact, just 1,600 Ugandan troops have shown up. Somalia may now be sliding back into civil war, with the country's internationally recognised but feeble government and occupying Ethiopian troops on one side, and the Islamists on the other. Adan Hashi Ayro, a ruthless jihadist commander linked to al-Qaeda, recently issued a battle-cry for Islamists to attack the Ugandans in Mogadishu. A first assault was repelled; others are likely to follow. Though Nigeria's generals say they are ready to deploy a battalion in Mogadishu, it is unlikely to go, despite American urging. A larger but inexperienced Burundian force is also meant to be flown in but shows no sign of arriving.

Peacekeeping in Africa has come a long way since the Irish army was sent to Congo in 1960, in woolly sweaters and carrying Enfield rifles, to head off mineral-rich Katanga province's bid for independence. The trauma of that first UN effort, together with cold war politics, meant that UN peacekeepers did not return to Africa until the late 1980s. The UN failed twice in Somalia and horribly so in Rwanda, failing to prevent some 800,000 deaths.

But it has had some successes too: in Angola, Mozambique, Namibia and more recently in Liberia and

Sierra Leone. The blue helmets have overseen elections in several African countries and plan to do so again in Côte d'Ivoire. They have also done a lot of de-mining and have helped disarm tens of thousands of fighters, including child soldiers. A new centre in Cameroon to train police for UN peacekeeping missions will open soon.

Yet if Africa is to begin to police itself, as everyone wants, its armies will have to become bigger and better. Some progress is being made. The British, with a military team in Kenya to serve central and eastern Africa, probably have the most detailed plan for improving African peacekeeping. Their commander, Colonel Andy Mason, a veteran of peacekeeping in Zimbabwe and Congo, says that Eastern Brigade, drawn from east African armies led by Ethiopia, Kenya, Uganda and Rwanda, may start operating by 2012 at a cost over five years of $500m. It will be trained to be ready to send 6,000 troops to a trouble spot within 90 days. The Africans want rich countries to provide the aircraft to get them there, though judging by the UN in Darfur that may be wishful thinking.

America has much deeper pockets than Britain but many African governments are put off by its relentless talk about the “war on terror” and its attempts, often viewed as clumsy, to butter up disenchanted Muslims, for instance by getting American soldiers to dig their wells and vaccinate their cattle. But the Americans may be getting more dextrous. A new America military command for Africa, AFRICOM, may help streamline the administration's competing military, diplomatic and aid plans. The commander of the American base at Camp Lemonier in Djibouti, Rear Admiral James Hart, hopes his force will be brought under AFRICOM next year. He says his forces are co-operating well with the Ethiopian and Ugandan armies, both of which are meant to help America against Islamist fighters in Somalia.

The Americans also say that it is more important that they should work harmoniously with Africa's existing regional military bodies, particularly Eastern Brigade. The French agree—and are now working more closely with the Americans in Djibouti, where both Western countries have bases. This week a French naval frigate was praised by the UN's World Food Programme for escorting two freighters loaded with food aid through pirate-infested waters to Somalia. In Chad as well as in Djibouti, French forces are close to the peacekeepers' front line. In past years, their aircraft and special forces have protected French interests. Now the French say they are putting their emphasis on training African armies.

When it comes to weapons, African armies still look for the cheapest deal—wherever they can get it. This week China's defence minister met Kenya's president and promised a host of military goodies to boost Kenya's role as a peacekeeper. But where are those helicopters?

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Nigeria

Bleak publishing houses

Nov 22nd 2007 | ABUJA
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Award-winning novelists have more readers abroad than at home

WHEN a bookstore in Makurdi, the central state of Benue, wants to buy Chimamanda Adichie's latest novel, “Half of a Yellow Sun”, it sends a text message to Muhtar Bakare in Lagos, down south. Mr Bakare, a publisher who heads Kachifo, replies with a bank account number and a price. Once the money is transferred from Makurdi to Lagos, Mr Bakare loads the books onto a public bus, which then begins a day-long trip to the other side of Africa's most populous country.

Though Ms Adichie's second novel, winner of this year's Orange Broadband Prize for Fiction, may have sold over 240,000 copies in Britain, in Nigeria it has shifted barely 5,000. Her book, like others by Nigeria's novelists, is stuck, often literally, in a publishing industry in shambles.

AFP

Adichie rewarded

Nigeria was once the centre of literary publishing in west Africa—not just for local companies but international houses as well. But when military rule and economic decline saw much of the middle class flee in the 1980s, the publishers left too. Today, there is no distribution network and scant demand for fiction.

In order to survive, publishers switched from literature to textbooks, certain to be bought by students and schools. Fiction is much harder to sell. By the time a novel is printed and transported across the country, the price may be as much as a tenth of an average worker's monthly salary. Ms Adichie's novel costs N850 ($7.30) from Kachifo and goes up to N1,500 in bookshops in Abuja, the capital. Far more readers choose self-help and religious books that are supposed to have a more immediate pay-off.

So pity the enthusiasts who persist in trying to sell novels. Mr Bakare likens his business to the telecom industry, which has had to build its own infrastructure from scratch. He is not building roads or relay towers but a network of bookstores, buses, taxis and bank transfers. Cassava Republic, a publisher founded last year, operates with a low profit margin for now, in the hope that it can cultivate a loyal base of readers that will one day meet costs. The founder, Bibi Bakare-Yusuf, says she wants her customers' “intellectual hunger to be as pressing as their stomachs”.

Her hard work may just be paying off. Ms Adichie says she is starting to get e-mails from all over the country—from Kaduna in the north, Lagos in the south and Makurdi in-between. She is flattered by the foreign attention but says that Nigerians are still her most important audience. “Half of a Yellow Sun” is mainly about the Biafran War, a conflict that, from 1967-1970, split Nigeria apart; its scars still linger. Ms Adichie is telling Nigerians about a history that was never taught in school—and which she wants more of her countrymen to know about.

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Strikes in France

The street fights back

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Reuters

The protests keep going and even turn nasty

“WE WILL not give in, we will not back down!” insisted a defiant President Nicolas Sarkozy, as France entered the second week of its rolling public-transport strikes. The next day, four high-speed railway lines out of Paris were found to have been sabotaged. Mainstream unions were quick to condemn the vandalism. But the longer the battle of wills between the unions and the government goes on, the greater the risk of protests turning to violence. Has Mr Sarkozy got the bottle to stick it out?

From the day when he was elected in May, promising a *rupture* with the past to modernise France, Mr Sarkozy was always likely to face a showdown with the unions. But the length and intensity of these strikes has taken even veteran observers of France by surprise. Entire suburban rail lines have been shut down, for days on end. Riot police have been drafted on to jam-packed platforms at Paris stations to control crowds of enraged commuters. Businessmen have been sleeping on office floors. France has not been so paralysed since 1995, when three weeks of strikes forced the government to back down from similar reforms.

There are many reasons why the strikes have persisted for so long. On paper, the transport workers, some of whom can retire at 55 or even 50, are simply protesting against changes to their special pension regimes. These will lengthen from 37½ to 40 the number of years of contributions that are required for a full pension, bringing 500,000 workers with special regimes into line with the rest of the public sector. Yet the strikes have now taken on a broader symbolism: against all planned reforms (magistrates will strike next week against judicial reform) and for higher pay (teachers, doctors and other public-sector workers have all staged one-day strikes this week). Above all, they have become a test of Mr Sarkozy's willingness to face down resistance to change.

It is not only Mr Sarkozy who is on trial. The unions know that this may be their last chance to cause widespread disruption, since a new law requiring a minimum level of service on public transport will take effect in January. Union leaders, under pressure from their more militant members, sense that their own jobs are on the line. Some union bosses have made conciliatory noises about negotiation, but in many cases their members have shouted them down. Hard-left unions, particularly SUD-Rail, which is close to the Revolutionary Communist League, have proved especially resistant.

All of which means that, as the government sat down this week for fresh talks with bosses and unions, it was hard to predict how much longer the disruption would continue. Each day, the strike turnout has dropped: from 61% of all rail staff on day one, for example, to 23% by day eight. Yet among train drivers,

it remains extremely high: at mid-week, 90% of those who drive the Paris suburban RER trains were still on strike. In other words, even though some unions have agreed to suspend the strike, the diehards could still cause trouble.

How will Mr Sarkozy respond? Unlike the government that tried and failed 12 years ago to reform the special pensions, he has both an explicit electoral mandate to press ahead, and public opinion broadly on his side. At various moments in 1995, 54-62% of those polled backed the strikers. Today, by contrast, almost every poll shows a majority in favour of the government. If anything, opinion has been hardening against the strikers. There has even been a pro-work demonstration in Paris.

Against this, polls show that Mr Sarkozy's popularity is sliding fast. One in *Le Parisien* this week showed him losing five points in a month. He may be tempted to give ground so as to secure a return to work, and get the bulk of his pension reform through. Already, there is talk of concessions on pay and final salaries, to sweeten the pension-contribution rules.

In an attempt to give the unions some space to back down without losing face, Mr Sarkozy insisted this week that the strikes were not about winners and losers. But it is hard to see them any other way. If he can end the strikes without paying too high a price in concessions, that will smooth the way for the next raft of reforms. If he gives away too much, that could be the end of any serious attempt to reshape France during his term.

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Europe and immigration

The trouble with migrants

Nov 22nd 2007 | BERLIN, BRUSSELS, PARIS AND ROME
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Europe is fretting about too much immigration when it needs even more

CAST your eye around Europe, and you find a funk about foreigners. Denmark's voters have given the anti-immigration Danish People's Party its fourth successive rise in voting share. The Swiss gave 29% of their votes to the xenophobic Swiss People's Party. An anti-foreigner party is the second-biggest in Norway. A fifth of Flemish voters in Belgium back the far-right Vlaams Belang.

In France, Nicolas Sarkozy won the presidency in May after aping the anti-immigrant rhetoric of the National Front's Jean-Marie Le Pen. He now talks of inculcating French values. Next year, when France has the European Union presidency, he will promote a similar idea at EU level. His new ministry of national identity and immigration has proposed quotas on immigrants from some regions that may be a ploy to keep out the dark-skinned. He has passed a law to limit immigration for family unification, which allows DNA testing to prove genetic ties.

French policy is measured by comparison with recent actions in Italy. After a Romanian migrant killed an Italian woman in Rome, Romano Prodi's government approved a decree to make it easier to expel EU citizens who are deemed a threat to public security. This pandered to the popular prejudice that Italy's half a million Romanian immigrants, often Roma (gypsies), are more criminal than other new arrivals. But it achieved little. Vigilantes attacked Romanians; police destroyed Roma camps. But as of mid-November, only 117 people had been served with expulsion orders; far fewer had actually gone.

Why are Europe's voters and politicians so stirred up? The short answer is that rates of immigration, from inside and outside the EU, are high, and have been rising for years. A report by Goldman Sachs, an investment bank, suggests that since 2001 migration has added 0.5% a year to Europe's workforce. It concludes that immigration in Europe has outstripped even inflows to America. In many European countries the stock of the foreign-born population has never been higher. As much as 24% of the Swiss population was born elsewhere, as was 12% of Belgium's.

The numbers alone do not explain why some countries are anxious and others less so. France and Denmark have foreign-born shares of the population of only 8% and 6.5% respectively. Some countries that are relatively more relaxed about immigration have much bigger shares: Sweden has 12% and Ireland 11%, for example. One explanation is that an inrush of immigrants may not provoke a backlash so long as the economy is strong.

Worries about immigration from poor countries have been around for years. The fresh element in many west European countries is a concern about immigration from new EU members in eastern Europe. Since the accession of eight countries from the region in 2004, followed by Romania and Bulgaria in January 2007, large numbers of migrant workers have moved (often legally and temporarily) from east to west. Britain, Sweden and Ireland opened up fully to workers from the east in May 2004 and have taken in many highly educated migrants, helping to sustain their long economic upswings. Countries that have seen housing booms have imported hundreds of thousands of lower-skilled workers, often from the east.

Spain alone is thought by the European Commission to be home to some 547,000 adults of working age from Romania and Bulgaria. Yet Spaniards, according to a poll this month for France 24, a television station, appear untroubled. They have the sunniest attitudes of all Europeans towards migration, with 43% of respondents saying that immigrants are a boon to Europe and 55% believing that they are good for the economy. The same poll suggested that 42% of Britons think immigrants are good for the economy, although fewer believe they benefit the country overall.

Yet even in Britain there is creeping anxiety about high immigration from within the EU. This is partly to do with foreign nationals (all those skilled Poles in London) who now take roughly half of all the new jobs being created in Britain. Other gripes are that schools, hospitals and roads are getting overcrowded. After its experience since 2004, Britain decided last January to keep its doors shut to migrant workers from

Romania and Bulgaria. Gordon Brown, the prime minister, aware of Mr Sarkozy's electoral success, even talked at the Labour Party conference of “British jobs for British workers”. He has pledged to restrict immigrants from any countries that join the EU in future.

Such talk may please voters, but the ebb and flow of EU migrants seems likely to be driven more by economics than by politicians. In the short run the rate of migration within the EU is likely to slow. Demand for foreign labour in western Europe may drop as housing markets slow and construction falls off. Years of strong growth in the east, combined with a steady outflow of workers, have led to serious labour shortages that are driving up wages. That reduces the incentive to leave, and increases the incentive to return.

In truth the bad demographic outlook of much of western and eastern Europe will make the continent increasingly reliant on foreign labour. And one irony is that, for all the current fretting about too many foreigners, a chronic shortage of suitable workers may be felt most acutely in the countries that seem most hostile to outsiders. Germany has kept its labour markets closed to new EU members until 2011, but it now admits to a skills shortage. This month it eased the restrictions on migrant workers in the mechanical and electrical-engineering industries.

Immigration already accounts for most of the limited population growth in Europe. Ageing populations, combined with the natives' lack of ability, or inclination, to do many jobs, mean that more foreign workers are likely to be needed. By one estimate Europe's native-born workforce will shrink by 44m by the middle of the century. Skilled workers will be in especially short supply. Those calling most fiercely for foreigners to go home may come to regret what they wished for.

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Jacques Chirac

A president on trial

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AFP

The former president is charged with embezzlement

EVEN the transport strikes did not distract from the news. On November 21st Jacques Chirac, who stepped down as president in May, was *mis en examen* (ie, charged) with embezzlement of public funds, relating to his time as mayor of Paris in 1977-95. The investigation concerns allegedly fake jobs created in the mayor's office between 1983 and 1995. Writing in *Le Monde* this week, Mr Chirac defended the jobs, arguing that “they were as legitimate as they were necessary.” “Never”, he said, “was there any personal enrichment.” In total, 20 people are under investigation.

Since his presidential immunity expired in June, Mr Chirac has been summoned for questioning in another investigation into fake jobs at the town hall. This was the case in which Alain Juppé, a former prime minister and Mr Chirac's right-hand man when he was mayor, was convicted of political corruption in 2004. Under French law, Mr Chirac has now been charged by an investigating judge. This means he faces more inquiries into the case, after which it will either be dismissed, or he will be sent to stand trial. That would be without precedent in modern French history.

Mr Chirac may be protected from implication in yet another judicial investigation, known as the “Clearstream affair”. This complex case concerns an attempt to smear some politicians, including Nicolas Sarkozy before he became president, by claiming falsely that they had profited illegally from an arms deal in 1991. Dominique de Villepin, another former prime minister, has already been charged in this case, and forbidden by judges from contacting Mr Chirac.

This week Michèle Alliot-Marie, the interior minister, confirmed that she would testify again in the Clearstream investigation. Mr Chirac's lawyer argues that his client is protected by the constitutional provision that “the president of the republic shall incur no liability by reason of acts carried out in this official capacity.” Some had expected that cases from Mr Chirac's time before he became president would be quietly dropped. But this week's events show that the judges are still resolved to get to the bottom of what happened on his watch.

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Italy's opposition

Subtle Silvio strikes again

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Silvio Berlusconi's makes big plans for a new party

IT WAS a typical Silvio Berlusconi manoeuvre: theatrical, unorthodox and, above all, unexpected. On November 18th Italy's centre-right leader turned up in a Milan piazza where his followers were collecting signatures for a petition calling for the ouster of Romano Prodi's centre-left government. Flanked by his favourite new political sidekick, Michela Vittoria Brambilla, a business association leader, Mr Berlusconi declared that he was creating a new party. Just one snag: he already has one, Forza Italia!, which he created in 1993. So what is he up to?

The obvious answer is: distracting attention from his own failure. For months, he has said that the centre-left is doomed and an election will be held by the spring. He needs one soon, for if the legislature runs its course, he will be 74 by the next poll. The Prodi administration is unpopular, largely because of tax increases, and has only a bare majority in the Senate. Yet on November 15th it showed its durability by getting its 2008 budget through. This sparked an explosion of recrimination on the centre-right. The leaders of all three parties allied to Mr Berlusconi attacked him for relying on showmanship and not offering alternative policies.

AP

Brambilla stays close to Berlusconi

Yet it has become clear since Mr Berlusconi's dramatic announcement that he is not only trying to seize back the initiative. The centre-left has done more to prepare for the bipolar party system to which Italy has been unsteadily moving. The two biggest parties in the Prodi government have merged into the Democratic Party, choosing the mayor of Rome, Walter Veltroni, as its leader. Despite Mr Berlusconi's urging, no such fusion is in sight on the centre-right. So he has decided to change the rules of a game he sensed he was losing.

At a press conference, he said he was giving up on bipolar politics which “can't be done in this country”. Instead, he was ready to discuss with Mr Veltroni a new electoral system along German lines: proportional representation, with a threshold for parliament. His only condition was that an election be held as soon as a deal was done. Mr Veltroni retorted that he was not about to mortgage the government. But the opposition leader's proposal must be enticing to a man facing three tricky years as Mr Prodi's understudy. The big question is if, in any election, his Democratic Party could best Mr Berlusconi's new Freedom People party (the precise name will be chosen on December 2nd).

Italy's richest man still hopes for a movement on the centre-right at least as strong as the Democratic Party on the centre-left. But his allies fear that, whereas he once sought to embrace them, he now intends to smother them. This is the significance of Ms Brambilla. Since last year, she has founded political clubs around the country with the aim of luring to the centre-right young Italians who are disenchanted with all existing parties. The suspicion is that Mr Berlusconi, once a political outsider himself, plans to fight the next election as representative of a new “anti-politics”. That would not be easy if he were linked to old school, professional politicians such as Gianfranco Fini of the National Alliance or Pier Ferdinando Casini, a Christian Democrat.

Mr Casini and his Union of Centre Democrats are already semi-detached from Mr Berlusconi's alliance. So there is concern in the National Alliance that it could be the victim of the new strategy. The party has already suffered an internal split which some believe Mr Berlusconi secretly promoted. His personal relations with Mr Fini have deteriorated spectacularly. One newspaper quoted him telling aides that, after pulling the then neo-fascists “out of the sewers” in the 1990s by bringing them into his government, it was time to send them back again. When he chooses, the ever-smiling Mr Berlusconi can play rough. Very

rough.

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Kosovo's future

The day after independence

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The next Balkan headache for the European Union

FOR months the future of Kosovo has been uncertain. In March Marti Ahtisaari, a former Finnish president, presented a plan for conditional independence to the United Nations, which has run the province since the end of the war in 1999. Russia stepped in to stop this, and has since treated Kosovo as a bargaining card with the West. The crude message was that, even though Kosovo is surrounded by the European Union and NATO, a resurgent Russia can still get its way there. Now it looks as if this may have backfired.

Kosovo has a population of 2m, 90% of whom are ethnic Albanians who have long demanded independence. Serbia's leaders say they cannot have it, since Kosovo was always a Serbian province and not a Yugoslav republic before the country fell apart. Serbia has proposed various models of autonomy, drawing on such examples as Hong Kong and the Swedish-populated Aland Islands, formally part of Finland. But Kosovo's Albanians have rejected them all. A final bout of diplomacy intended to reach a compromise has, predictably, failed so far to find one.

The diplomats will present a report on their work to the UN on December 10th. Russia and Serbia want the talks to go on after that. But their chances of success are diminishing. “The intriguing thing,” comments Mr Ahtisaari, with not a little hint of satisfaction, “is that the Russian attitude has reinforced the unity of the EU. I don't think that was their original intent.”

Kosovo's Serbs were told to boycott the election on November 17th by their leaders, and only 40-45% of Kosovar Albanians turned up to vote. The election was won, with 34% of the vote, by Hashim Thaci, a former political leader of Kosovo's guerrillas who fought against the Serbs in 1998-99. After the poll he said Kosovo would declare independence immediately after December 10th. But privately he told Western diplomats he could wait until spring; he then said nothing would be done before consulting the Europeans and Americans.

Many countries wonder if Kosovo's independence is a good idea. Some fear a precedent for separatists, from Abkhazia to Catalonia. At one time, the European Union looked set to be divided over recognition. But a likely German decision to say yes, plus what seemed a scary bid by Russia to exploit Kosovo to divide the EU, has converted many doubters. Only Cyprus is likely to resist to the bitter end. Slovakia and Greece seem resigned to accepting Kosovo's independence.

This is a big success, says Ivan Krastev, a Balkan analyst, “but the problems will come later. It must be understood that EU unity cannot expire on the day after the recognition of Kosovo.” What this implies is a

large EU commitment to the region, beyond replacing the UN mission in Kosovo with an EU one. It is not clear that all European governments are prepared for this.

Several things need to be done in the wake of Kosovo's probable independence. The most delicate are careful handling of the Serb breakaway northern bit of Kosovo and the reinforcement of pro-European voices in Serbia. The second may involve some unpalatable decisions, such as setting aside the condition that Serbia's advancement towards EU accession must be conditional on the arrest of Ratko Mladic, a Bosnian Serb general wanted by The Hague war-crimes tribunal.

Another place causing concern is Macedonia, where recent violence involving ethnic Albanians has set nerves jangling. Macedonia hopes to be invited to join NATO next April. That would warn off predators in what by then may be a newly independent Kosovo. But it may not happen, for Greece threatens to veto a Macedonian invitation as part of its 15-year-long campaign to get it to change its name.

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Poland's government

All that glisters

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The new Polish government may find it hard to deliver on its promises

SUSPICION and confrontation were the hallmarks of Poland's previous government. The new centre-right Civic Platform marks a big change. Attacks on the government by Law and Justice, the former ruling party led by Jaroslaw Kaczynski, have been met with quiet steel. Civic Platform's amicable negotiations with its junior partner, the Peasants' Party, contrast with Mr Kaczynski's suspension of three colleagues for advocating more open discussion in his party.

The new prime minister, Donald Tusk, is mild-mannered but not overly meek. His competent cabinet includes two Poles with strong foreign links. Jacek Rostowski, a graduate of the London School of Economics, is finance minister. Radek Sikorski, an Oxford graduate who worked at the American Enterprise Institute before serving as defence minister in Mr Kaczynski's government and then defecting to Civic Platform, is foreign minister. The Peasants' Party leader, Waldemar Pawlak, an internet enthusiast, will be deputy prime minister. His party is more amenable than the extreme populist junior partners in Mr Kaczynski's coalition.

Mr Rostowski faces the biggest challenge: keeping the economy on track, if it falters in 2008 after growing by 6.5% this year. Public-finance reform is pressing; so are wage demands by teachers and health-care workers, stoked by labour shortages. It may be easier for Mr Sikorski to patch up relations with Poland's neighbours and European partners, bruised by the previous government's eccentric diplomacy. But the new government is more dubious about America's planned missile-defence system.

Meeting voters' inflated expectations on road-building, housing and rural development will be hard. So will dealing with the boisterously disruptive tactics of Law and Justice, which raised so many procedural objections that it forced the first post-election session of parliament into recess. It is now boycotting the intelligence committee in an argument over its composition.

But the deepest problem may be the relationship between Mr Tusk and President Lech Kaczynski, twin brother of Jaroslaw. The president has made clear that he considers Mr Tusk a second-best choice, blaming a hostile media for depriving his brother of a second term. The constitution obliges the heads of state and government to co-operate closely, particularly on foreign policy and defence. It seems that the president is determined to use all the means at his disposal to promote his own vision of domestic and foreign policy.

Poland's new government has catching up to do after the past two years. It will also need some luck. Its many well-wishers abroad can only hope it gets it.

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Charlemagne

In defence of national interests

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There is a good case for a smaller European Commission—but also some counter-arguments

Illustration by Peter Schrank

ONE of the better jokes in Brussels is the oath sworn by European commissioners to be “completely independent” of their home countries. They promise to act in the general European interest, and “neither to seek nor to take instructions” from any government. Having taken a vow of supranational celibacy, they are barred from talking about “my country” or “my government”. If commissioners refer to their homeland, they are supposed to mumble about “the country I know best”.

Recent weeks have exposed with some clarity the hypocrisy of such promises. Consider the heated scenes at a meeting on November 13th, when the commissioner for multilingualism challenged the commissioner for justice, freedom and security to speed up a probe into an Italian government decree allowing local authorities to deport Romanian immigrants. Seen through the lens of their official European Union functions, this exchange sounds baffling. But all becomes clear when one learns that the multilingualism commissioner, Leonard Orban, is from Romania—where the press were baying for Brussels to defend their migrants. In a piquant coincidence, his colleague in charge of justice policy, Franco Frattini, is Italian.

So it always goes. Efforts to lard the commission's progress report on Turkey's EU membership talks with references to its dispute with Cyprus were led by the health commissioner (from Cyprus), backed by the environment commissioner (a Greek). A bid to establish common rules for taxing corporate profits is in the deep freeze after “furious” lobbying by the single-market commissioner, Charlie McCreevy, who hails from Ireland, a low-tax place that might lose out from any fiscal harmonisation. According to insiders, Mr McCreevy's killer argument was to warn his colleagues not to imperil an EU treaty referendum in his country—sorry, the country he knows best.

To those who dream of a federal Europe, such interventions smack of the vice of selfish national interests, sullying what should be a sanctuary for European unity. If you see the commission as a European government in embryo, it is infuriating when its collegiality is threatened by expansion to 27 members, and its prestige is damaged by national lobbying.

Today, each EU country has one commissioner, which is why some new ones have been given what one Eurocrat calls “largely fictitious” portfolios (such as Mr Orban's). Even with a disciplined chairman, a *tour de table* by the full “college” takes about two hours. Commissioners were once “very respected, high-level people”, says an official. With 27, “I am not sure most officials could name all of them.” Enlargement has also eroded the old, clubbish ways. Long-time Brussels hands mutter that the crudest lobbying around the table is on behalf of the 12 countries that have joined the EU since 2004. As one points out, “it is evident

that in the political culture of the new member states, the exact role of a commissioner is not understood."

Maybe so. But the EU shuns national interests at its peril. They are at worst predictable, and at best rational expressions of real political differences between EU nations. Irish politicians like Mr McCreevy sincerely believe that lower taxes make countries competitive. National politicians turned commissioners offer first-hand political intelligence from their home countries—information that grows more valuable as the club expands.

There is also the small detail that all EU members, including founding members, expect shameless lobbying from their commissioners when the need arises. National flag-waving is most blatant during the commission's infringement meetings, insiders say. These marathon sessions, held four times a year, consider whether to take governments to court for flouting bits of EU law. Commissioners feel duty-bound to weigh in on the most sensitive cases (guided, it is sometimes claimed, by detailed briefings from their national governments).

No more one man, one vote

All of which raises serious questions about how the commission will fare after 2014, when it is to stop offering a seat at the table to every EU country, in the name of efficiency. Under the new treaty, the commission will shrink, so that only two-thirds of the union's members have a commissioner at any one time, with membership passing by "strictly equal rotation".

In a speech last year, Nicolas Sarkozy (then a French presidential candidate) declared that a rotating commission that left out some countries risked putting efficiency ahead of legitimacy. He cited the "understandable wish on the part of some member states" to have a seat at the commission table. In an ill-concealed demand for France to have permanent commission representation, Mr Sarkozy asked rhetorically how public opinion would react if a commission decision threatened the survival of a big company in a given country, and nobody from that country was among its ranks.

As president, Mr Sarkozy failed to overturn "equal rotation" during the treaty negotiations. But his point about legitimacy remains. Ordinary Romanians might feel (more) disappointed with the muted EU response to the Italian fiasco, were Mr Orban not there to pile in on their behalf, his multilingualism dossiers temporarily cast to the winds.

Efficiency offers a strong argument for shrinking the commission. The EU could soon have 30 members, and employing 30 commissioners would do harm if all tried to create work with a flood of micro-managing directives. But prestige is a poor argument for change: in the real world, it may not matter that some commissioners are not recognised by their own Eurocrats. Nor is it a vice if top Eurocrats cannot forget their national origins: it is simply human nature. To adapt an old French aphorism, hypocrisy is the tribute paid by national interests to the (frankly Utopian) virtues of European union. If that means the odd broken commissioner's oath, so be it.

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Alistair Darling and Gordon Brown

Red faces, black week

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From The Economist print edition

The prime minister will find it hard to avoid the blame for mistakes at the Treasury

PA

Gordon Brown

TO ERR may be human, but some blunders are so egregious that they fall into the “you couldn't make it up” category. Unfortunately for Gordon Brown's beleaguered government, there was no make-believe about the loss of 25m child-benefit records, which Alistair Darling, the chancellor of the exchequer, disclosed on November 20th to the House of Commons.

The scale of the security lapse at the Treasury's tax agency—affecting almost half the British population—was breathtaking. Two computer discs containing the names, addresses and dates of birth of 9.5m parents and 15.5m children, together with their national-insurance and child-benefit numbers and bank-account details, have gone missing. Although there is no evidence that the records have yet been misused, they would be a treasure trove for identity fraudsters. In itself, the information would not permit crooks to dip directly into bank accounts, unless they struck lucky with passwords and PIN numbers. It would, however, help those so disposed to create and use false identities.

If the loss was cause for alarm, the details of how the records went astray were occasion for embarrassment raised to the power of squirm. A junior official at HM Revenue and Customs (HMRC), the tax-collection department which also pays out benefits to families, had breached security guidelines by plonking the discs in the internal-government post run by TNT, a private courier. It was only when they failed to arrive at their destination, the National Audit Office (NAO), Parliament's spending watchdog, that the security breach came to light. Mr Darling was informed of the loss on November 10th; the public heard about it ten days later. The information on the discs was protected by a password but was not encrypted; the mail had not even been registered; and the NAO did not want the addresses and bank-account details anyway, it says.

Before Mr Darling became chancellor this summer, he enjoyed a near-mythical renown at Westminster and beyond as a soporific secretary of state who could drain media interest out of tricky policy briefs where Labour was politically vulnerable, such as pensions and transport. But sorrows have recently been coming to him not as single spies but in battalions. The same day that he revealed the security breach, official figures suggested that the government would have to borrow more money in 2007-08 than it had forecast just a month earlier. In October the chancellor said that the budget deficit would come to £38 billion ($78 billion), up from the £34 billion projected in March. But if current trends continue, borrowing may reach £42 billion, says the Institute for Fiscal Studies.

Worse still for Mr Darling, his announcement about the missing benefit records came hard on the heels of another embarrassing statement—about Northern Rock, a mortgage lender that has been propped up by public cash since its call for emergency help and a run by depositors in mid-September. Until this week the chancellor had given no indication that the taxpayer might incur losses on the credit provided by the Bank of England, which has ballooned to some £24 billion while eight or so private rescue bids have been put together. But on November 19th Mr Darling seemed to change that line when he told MPs that he was looking for “the best outcome for the public purse”.

As if all this were not enough, Mr Darling's fiscal statement in October, in which he announced some hastily cobbled-together tax measures, has backfired badly. In particular, his surprise decision to shake up capital-gains tax has angered small businesses, the main victims of the change. Following a concerted campaign by business lobbies such as the CBI, the chancellor has been forced to signal some concessions to ease the pain.

Catching Macavity

Mr Darling may be taking the flak but he can shield his boss only partially. Likened earlier this year by Lord Turnbull, a former cabinet secretary (Britain's top civil servant), to Macavity the cat, who was never to be found at the scene of the crime, the prime minister will find it hard now to evade his own responsibility for what has gone wrong on Mr Darling's brief watch. It was Mr Brown who, at the start of his decade-long tenure as chancellor, insisted on stripping the Bank of England of its role in supervising banks, a reform that failed its first real test with Northern Rock. And it was Mr Brown who left the public finances in a dodgy state after presiding over an extended spending spree.

The prime minister's personal responsibility may extend beyond this if it can be shown that HMRC's failings are linked to an administrative merger and job cuts that he pushed through as chancellor. The Tories allege that cost-saving imposed by senior officials lay behind the cock-up. But what matters even more is that Labour is once again in the dock for incompetence.

Under Tony Blair, Mr Brown's predecessor, the government got a reputation for bungling, with notable mishaps at the Home Office. When Mr Brown took over, his calm handling of incidents as varied as a terrorist plot and summer floods raised hopes that he could at least run a competent if uninspiring government. But this week's string of disasters suggests a potentially fatal loss of grip in the economic and financial realm where he and Labour had once appeared so effective.

The lost benefit records have already caused the resignation of Paul Gray, chairman of HMRC. Mr Darling will be next in line if the security breach leads to actual fraud. But the chief loser is likely to be Mr Brown. After his self-harming election that wasn't, the prime minister has been badly hurt by this week's disasters. Mr Brown is not yet a lame duck, but his hopes of leading anything more than a tail-end government look increasingly forlorn.

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QinetiQ

Boffins in the money

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Mistakes from one privatisation may hold important lessons for Northern Rock

WHEN private-equity firms bubble into the public consciousness, they are generally viewed with disdain as the embodiment of capitalism red in tooth and claw. Rarely are they seen as a force for good, or as protectors of the public interest. So the industry's opponents—of whom there are many—are likely to react with glee to a report due to be released by the National Audit Office (NAO) on November 23rd. The spending watchdog lambasts the government for its handling of the sale of QinetiQ, once the Ministry of Defence's research arm.

The deal has attracted much attention, not just because it was unusual—few governments are willing to part with the most sensitive bits of their defence industry—but also because of how much money was made on it. Carlyle Group, an American private-equity firm with an uncommon penchant for hiring former heads of state, invested £42m ($74m, at the exchange rate of the day) to acquire 34% of QinetiQ in 2003. More than three years later, when the company was floated on the stockmarket, Carlyle's share was worth £374m. The civil-service managers of QinetiQ did well too. Stocks for which the ten most senior ones together paid little more than £0.5m increased in value to £107m.

Making money, even lots of it, is no crime. And if it were, the state itself would be in the dock. The two-stage privatisation of QinetiQ yielded proceeds of more than £576m for the government, which still has a stake in the firm worth some £235m.

The report will nevertheless make uncomfortable reading for ministers and their minions. The NAO details a host of blunders that cut the return to taxpayers while allowing the civil servants running the company and the private-equity firm buying it to line their pockets.

The report points in particular to conflicts of interest when Carlyle first acquired a stake. The future compensation of QinetiQ's managers was tied to the increase in the firm's value. Yet they were free to discuss bonuses with potential buyers before the winning bid had been selected. And non-executive directors were allowed to buy shares in the firm when Carlyle did. Though there is no evidence that either group was in breach of its duties, both stood to gain from undervaluing the firm in 2002.

Worryingly, the government also concluded negotiations over important defence contracts with QinetiQ only after the selection of Carlyle as a “preferred bidder” for it. There were then no rival bidders to turn to when Carlyle reduced its valuation of the firm by £59m.

Disquieting though the report is, it could not have come at a better time. Treasury officials huddling over the bids trickling in from private-equity firms and others for Northern Rock, the stricken mortgage lender, would do well to read it before blithely signing a deal.

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Football woes

Skills gap

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From The Economist print edition

Why England's footballers keep underachieving

FOR a nation that invented the sport, the British are not much good at football. England may be home to the Premier League, perhaps the best club competition in the world, but half of the players fielded on any given weekend are neither British nor Irish. In a recent round of the Champions League, which pits 32 top teams across Europe against each other, there were barely ten English players, compared with more than 50 Brazilians and some 30 players each from France, Italy and Spain. There were also more Argentines, Germans, Romanians, Turks, Czechs, Serbs and Dutchmen. On November 21st the English national team, which has reached the final of only one tournament (the 1966 World Cup), was knocked out of next summer's European Championship.

This is part of a wider phenomenon some call “the Wimbledon effect”. England's Lawn Tennis Association, the world's richest tennis body, hosts the sport's most prestigious competition—and no Briton has won it for 30 years. Britain is spending £9 billion ($18.5 billion) or more to host the 2012 Olympics, but Colin Jackson, a former athlete, says it will take a “miracle” for Britain to win a gold medal in any track or field event. The country invests in bricks and mortar and marquees, but not in the skills of its sportsmen.

In football, Britain's main sport, some Luddites think the open labour market is to blame for the lack of local talent. They include Gerry Sutcliffe, the sports minister. On November 14th he argued that, as British clubs face no obligation to field players of their own nationality, they lack an incentive to develop home-grown talent. But this does not explain why other countries with the same rules prosper. Foreign players are cheaper to buy, but that is because there are more of them who reach the required standard. And when there were few foreigners in English football, the national team was no better.

The real problem, say Mr Sutcliffe's critics, is that the English do not develop their young players properly. Youth coaching, traditionally led by schools, was overhauled in 1997 by the Football Association (FA), the sport's governing body in England. More responsibility was transferred to professional clubs, which were required to improve their in-house academies.

But even these lag behind their European rivals in the quantity and quality of their coaching. A player at an English academy typically has two or three coaching sessions a week; on the continent, he could expect five. Damien Comolli, the sporting director at Tottenham Hotspur, a London club, calculates that a player in his native France clocks up 2,304 hours of coaching between 12 and 16, twice as many as an English player. And whereas the Englishman will spend much of that time playing matches (a poor way to develop skill, as each player spends a small fraction of a game in possession of the ball), the continental will be honing his technique.

Spain, Portugal and Holland all have excellent youth systems, but it is Mr Comolli's country that has set the standard since 1988, when its vaunted Clairefontaine national academy opened. France failed to qualify for the World Cup in 1990 and 1994. In 1998 the French won it, along with the European Championship two years later. (Thierry Henry, one of the first batch of Clairefontaine graduates, was their top scorer both times.) They reached another World Cup final last year. But the FA's plans for an English version of Clairefontaine in Burton-upon-Trent have been stalled for five years, partly to pay for a new football stadium at Wembley and partly to placate clubs, which fear losing control over their young charges.

In any case, the problem runs deeper: Sir Trevor Brooking, the FA's director of football development, believes British players are already “damaged goods” by the time they enter academies, typically at the age of nine. More dangerous streets and disappearing playing fields have made the casual kickabouts in which youngsters first develop their skills increasingly rare. This is compounded by a dearth of good coaches at the grassroots—the money and prestige lie in coaching older prospects. As a result, the talent pool from which academies recruit is deficient. And by then it can be too late: physical and tactical prowess can be developed at any age, but technique must be acquired early.

Support for restricting the inflow of foreign players is growing, and it echoes concern about foreign workers in the wider economy. Mr Sutcliffe's comments call to mind the recent promise of Gordon Brown, the prime minister, to provide “British jobs for British workers”: there is, it seems, greater political desire to protect citizens from immigrant labour than to improve their ability to compete with it. But freedom of movement within the European Union makes such notions impractical, and many in the game regard them as risible. A review of youth development, commissioned by the FA and other football bodies and published in July, rejected the idea of quotas in favour of improving coaching, particularly of children from five to 11 years old. These voices deserve to prevail. In football, as elsewhere, protectionism merely coddles the mediocre.

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Pre-charge detention

In the slammer

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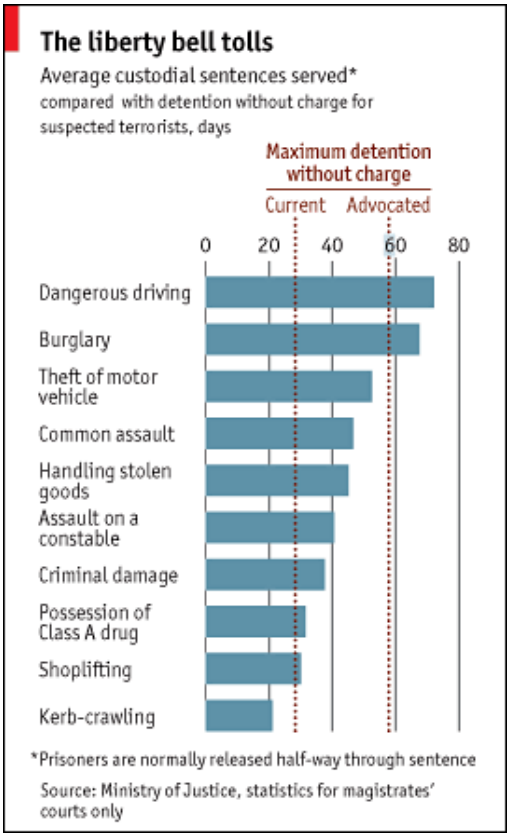
Terrorist suspects are serving longer sentences than convicted criminals

LIKE most countries in al-Qaeda's bad books, Britain faces a dilemma about how harshly to treat suspected terrorists. Fearful of more bomb plots like the one that murdered 52 people in London on July 7th 2005, the government wants to let the police hold suspects for longer before charging them with a crime. Avowedly anxious that hard-won freedoms should not be carelessly swept away, opposition parties are applying the brakes.

The debate about the number of days that suspected plotters may be held before being charged has come to resemble a grim game of bingo. Until 2000 the limit was four days; then it became seven, then 14. An attempt in 2005 to raise it to 90 was defeated by MPs and 28 became the new limit, which still stands. Now Gordon Brown, the prime minister, wants to double it again, to 56 days—or perhaps 58, some whisper. Firm plans will be put to MPs within weeks.

Picking the right number is not a straightforward trade-off between liberty and security, since every crackdown risks converting more jihadists. Yet the main calculation is familiar: for how long should the state be allowed to lock up a person who may be innocent for the sake of lessening the chances of broader disaster?



The various suggested periods of pre-charge detention can be set in context by examining what sort of crime an ordinary crook would have to be found guilty of to be locked up for the same length of time. Suspected terrorists, not yet guilty of anything, can already spend longer in jail awaiting charges than some convicted criminals do as punishment (see chart).

Under the current rules, terrorism suspects can be detained for about as long as convicted shoplifters. Men who are jailed for kerb-crawling spend less time behind bars. And it is not as if terror suspects always go on to be charged: so far nearly two-thirds have been let off, including three who spent 27 or 28 days banged up. If the 28-day limit is doubled, the penalty for merely being suspected would outweigh the average sentence in magistrates' courts for stealing a car or handling stolen goods (other courts can give stiffer ones).

Parliament must soon decide whether the risk and sophistication of terrorism has risen enough to permit this. The evidence that it has is still scant. On November 21st Sir Ken Macdonald, the head of public prosecutions, told MPs that prosecutors were coping “comfortably” with the current limit. Earlier Lord Goldsmith, the attorney-general until June, said he had seen nothing to convince him that 28 days was insufficient.

Mr Brown hates such dissent. On November 14th Lord West, a former head of the Royal Navy and now the security minister, came out as a sceptic on longer detention. After a revelatory breakfast with Mr Brown, Lord West, who supposedly advises the prime minister on security rather than vice-versa, announced that he had changed his mind. Mr Brown may not be swayed by the evidence. Britons must hope that MPs are.

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Improving schools

Best for everyone

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From The Economist print edition

A decade of education reforms—and lessons still unlearned

THE building is striking enough, if you like that sort of thing—chunky render painted azure and sunshine yellow; the school's name on the side in huge lettering. Inside, though, it is beautiful, with airy walkways and bright, quiet classrooms. The head teacher, Sir Michael Wilshaw, shows visitors the sports hall and theatre with pride. “Who knows what a journalist is?” he asks a class of children with severe learning difficulties. Hands shoot up.

This is Mossbourne Community Academy in Hackney, east London, which was opened in 2004 to replace Hackney Downs, a notorious failure. It is independent from local government although entirely state-funded. Its sponsor (Sir Clive Bourne, a local boy-made-good who died this year) chipped in £2m towards the buildings and plenty of good advice. The uniforms are aggressively smart, classes are grouped by ability and rules on behaviour are unbending.

David Cameron, the Tories' leader, and Michael Gove, their spokesman on schools, chose Mossbourne to talk on November 20th about what their party would do to improve education. More schools like Mossbourne, was the gist of it, to be set up by philanthropists, charities and parents, with local government kept well out of it. Mr Cameron called it a “supply-side revolution”, and invoked Sweden's school-choice reforms of 1992.

The choice of venue was pure political theatre, enlivened by some audacious cross-dressing. Of all the “academies”, as these independent state schools are known, none was dearer to the previous prime minister, Tony Blair, than Mossbourne. In 2006 he gave a speech there on his education reforms, his successor, Gordon Brown, by his side.

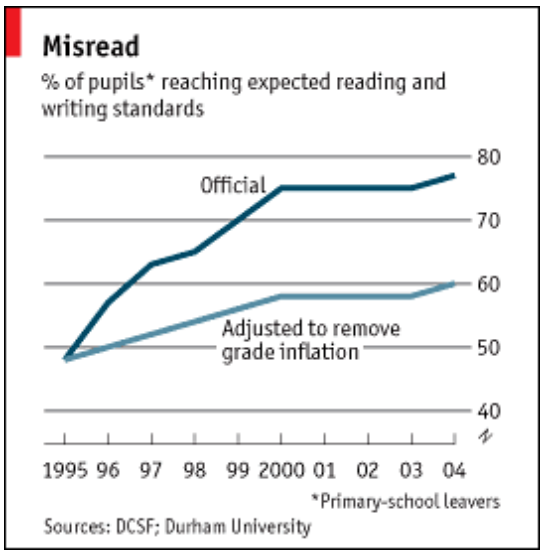
By planting himself in front of the cameras at Mossbourne Mr Cameron conveyed two messages: that the Tories would continue Mr Blair's reforms—and that Mr Brown would not. Evidence of the latter is growing clearer. Earlier this month Mr Brown ordered an urgent review of academies. More are to open, bringing their number to 400, but they will have to follow the national curriculum (although innovation in teaching was an aim of the programme). And local authorities may now run academies (although prising their grip from schools was another).

It takes political determination to counter the inertia of local government. In 2005 Tower Hamlets turned down an offer from Goldman Sachs, a bank, to sponsor an academy, saying it could run schools just fine itself. And earlier this year another London council, Haringey, competed to open a school under new rules—and won the competition (which it ran itself).

The contradiction at the heart of Mr Blair's reforms was always the absurdity of removing the dead hand of local government, only to impose an even tighter grip from the centre. Over the past decade schools have been showered with directives on everything from school meals to classroom layout. Syllabuses and teaching methods have been specified narrowly. Although academies can ignore their local councils, to set one up requires approval by the schools department in Whitehall.

Centrally imposed targets have distorted both what is taught and measuring how well it is taught. Nowhere is that clearer than in official figures showing that standards in reading and writing have soared. Independent observers say these are unreliable, because teachers have learned to coach children and there is unspoken pressure for scores to rise. In 2005 the Statistics Commission, a numbers watchdog, backed private researchers who said most of the claimed improvement in the performance of children leaving primary school was illusory (see chart).

Sadly, this lesson appears to have gone unheeded. Mr Cameron did not confine himself to talking about new schools and parental demand. He also laid out detailed plans for bossing schools around. All are to bring in uniforms, all are to group children by ability—and all are to teach reading in a particular way. A pity.



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Learning Mandarin

False Eastern promise

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From The Economist print edition

The craze for teaching Chinese may be a misguided fad

“CHINA will be the dominant power in the 21st century and the employment opportunities that speaking Mandarin will give are immense.” Thus Anthony Seldon, headmaster of Wellington College, at a conference in 2006 entitled “Why every school should offer Mandarin”. Nearly two years later, the spectacular growth of the language in British schools shows no sign of slowing. More than 400 secondary schools now teach it, according to the Specialist Schools and Academies Trust, which is lobbying to bring Mandarin into the national curriculum. And Britain is not alone in its enthusiasm for the language: some 30m foreigners are studying Mandarin today, and Chinese authorities expect the number to rise to 100m by 2010.

In a few decades China may indeed overtake America as the world's top economic power. Will Britons who make the effort to learn its language be rewarded with better careers? Barring some kind of sea change in global language learning, the answer will almost always be no.

With its tones and horribly complicated writing system, Mandarin is much harder to learn than most European languages. The Foreign Office, for example, gives its officers four times as long to get from beginner to operational level in Mandarin as it does in Italian, French or Spanish—and only those with the greatest aptitude for languages are selected for it. The vast majority of Westerners who travel to China to study Mandarin give up, go home and forget what they have learned. Undergraduates at British universities find it hard to adjust to a workload heavier than that for other subjects, and many drop out.

For those determined to become fluent in Chinese, a good level to aim for is a score of six in the national standard “Hanyu Shuiping Kaoshi” exam. This is the qualification foreigners need to enroll alongside local undergraduates at a Chinese university. A graduate in Chinese from a British university should reach that grade (though many do not). So should someone with good linguistic ability who studies Mandarin in China full-time for three years.

But is learning moderately good Chinese worth the opportunity cost? After all, in three or four years a British graduate could get most of the way to qualifying as a lawyer, for example. According to the Association of Graduate Recruiters, those who hire British graduates attach little importance to language skills in general. So to justify the extra effort needed, the demand for fluency in Mandarin would have to be way above demand for, say, French.

Yet anecdotal evidence suggests that there is little call for Britons with Mandarin. One reason is that many Chinese already speak reasonable English. In China's bigger cities children often start learning English in reception year. It is compulsory for all from the start of secondary school to the second year of university. To study for a doctorate, even in fine art or the poetry of the Tang dynasty, students need to show fluent literacy in English. An academic career is closed to those who cannot do so.

Outside the classroom, too, there is widespread conviction that a child's prospects will be limited if he does not learn English. Senior managers with no capacity in the language are becoming a rarity. China's elite professionals are often bilingual because most of them went to university in America, Britain or Australia.

For this reason, Britons at home never need to use Mandarin in their dealings with Chinese firms. Haier, a white-goods maker, for example, reports that every Chinese employee posted to its 15 overseas industrial parks, 22 trading companies, 30 plants and eight R&D centres outside China speaks good English.

Within China companies can hire an expatriate who speaks Chinese. Or, more often, they take their pick from an abundant supply of local graduates in English who are happy to work for 2,000 yuan (£130) a month. “I took an 80% pay cut to come here because I wanted to learn the language,” says Ken Schulz, a software engineer from Silicon Valley who studied Chinese full-time for four years at Beijing's University of Language and now works in the capital at WorkSoft, an outsourcing firm. “I'm the only foreigner in an

office of 1,200 people, and I hardly get any opportunity to use my Chinese."

At Search Bank, a Beijing employment agency, Hai Yuen points out that, whereas the value of compensation packages for expat executives has been shrinking over the past ten years, the number of Chinese-speaking foreigners she handles has been rising. Better language skills, she reckons, are a product less of market demand than of a general enthusiasm for China. Reason enough, perhaps, to learn the language.

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Heathrow

Turbulence

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Busiest—and soon to be even bigger

THE experience is so miserable it even has its own name: the “Heathrow hassle”. The world's busiest international airport is overcrowded, prone to delays and infuriatingly likely to lose your luggage. On November 14th City bigwigs told the chancellor, Alistair Darling, that subjecting travellers to such awfulness is bad for business. A poll for *Intelligent Life*, our sister quarterly, puts Heathrow wheels and undercarriage below all other airports for sheer misery.

Just what makes travelling through Heathrow so stressful was set out in a report published on November 21st by the Department for Transport. Everything, is the answer, from packed lounges and poor layout to queues and more queues.

Still, things may soon improve. A fifth terminal, due to open in March 2008, will help with overcrowding and delays at check-in; a new baggage-handling system should reunite luggage with its owners more often, and more quickly. An official investigation now under way might force BAA, the airport's owner, to sell some of its other airports—increasing competition and improving services.

Harder to see an end to are the monstrous security queues. Tedious though they are, ziplock bags are needed to fend off terrorist belts, shoes and toiletries. Plans to allow passengers to carry more hand luggage may make these worse, although proposals from the aviation regulator would see BAA facing big fines unless it cuts queues.

The basic problem is that Heathrow is serving 67m passengers a year when it was designed for 45m. And signs of pent-up demand are clear to see. A plane takes off or lands every 45 seconds, meaning that even minor events, such as a thunderstorm or high winds, can cause delays and cancelled flights. A third are more than 15 minutes late. Half of all arriving aircraft are stacked in a holding pattern before being allowed to land.

It is difficult for Heathrow to expand, located, as it is, near valuable real estate, whose well-heeled occupants squeal loudly when their peace is disturbed. Yet that is what the government intends should happen. It wants a third runway, “if this can be operated within strict environmental limits on noise and air quality”, as well as a loosening of the restrictions on take-off and landing that currently give some respite to angry residents under flight paths. Ruth Kelly, the transport secretary, launched a three-month consultation on these plans on November 22nd.

If the consultation comes down on the side of expansion, Heathrow's owners will still have to apply for planning permission. But plans to allow government to ram through big infrastructure projects without a public inquiry—cooked up by Ms Kelly in her previous incarnation as communities and local government secretary—may help there.

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Bagehot

Taste the sausage

Nov 22nd 2007
From The Economist print edition

History and personality have hamstrung Gordon Brown. But he is not—yet—as fated as John Major

Illustration by Steve O'Brien

Gordon Brown

STUN the pig, hang it up by its trotters and slice it open. Decant some blood, pull out the organs and other unwanted bits, then squeeze them into a tube of scraped intestine.

Sausages are indeed harder to swallow if you know how they are made. So, Bismarck famously observed, are laws. The same might be said of Gordon Brown's premiership—because, alas, it looks as if many of the unappetising things said about him before he became prime minister are true (and, as Mr Brown's luck would have it, they were said again in a documentary series starring his predecessor that began airing this week).

It is true, or seems to be, that Mr Brown is maniacally ambitious but politically timid. He is intellectually curious but cripplingly indecisive. Witness the barrage of procrastinating policy reviews that he unleashes in every speech; unsurprisingly, more were set up this week, after the tragicomic loss of two doomsday discs by the revenue and customs service (HMRC). It is true, as the uncharitable gave warning, that Mr Brown copes badly with criticism—so badly, it turns out, that he sometimes shakes with pain and rage. He appoints supposedly independent ministers, then bullies them into line-toeing submission. He shies from blame when it is due and sucks up credit when it is not.

Unfortunately, the gristle and the guts—the ugly secrets of the Brown abattoir—have been gruesomely displayed for all to see. During the non-election fiasco in October, the country witnessed the low political calculation and fake ecumenicism, the shallow bombast and obfuscation, the indecision and ultimately the cowardice. In the first days of the Northern Rock crisis, it saw—or rather didn't see—Mr Brown hide behind the sofa that he kept in Number 10 when Tony Blair left, just as he kept the uncollegial approach to government associated with it. Those who thought he could shuffle off his old skin when he realised his prime-ministerial dream, or at least that his psychological tics would not warp his tenure, seem to have been wrong. For Mr Brown, perhaps personality is destiny after all.

Just as ineluctably, history seems to be his destiny too. Mr Brown's pitch was that, as prime minister, he would offer a change, not only from his own earlier incarnation but also from the previous decade of Labour rule. For a while the strategy was surprisingly successful; it has now comprehensively collapsed.

The truly damaging thing about the HMRC fiasco is not that it undermines Mr Brown's claims to have governed competently since June. It is that, like the ongoing embarrassment over Northern Rock (which is partly to be blamed on the regulatory system Mr Brown designed), it has reminded the public of Labour's chequered record, and of Mr Brown's role in it. This is an old and flawed government, these debacles remind people—and the architect of some of those flaws is now leading it.

So there is no escape from the past. Between them, it now seems to many, history and personality have scuppered Mr Brown's administration. He and Labour have accumulated too many mistakes and behaved too distastefully, some think, like John Major's cabinet in the mid-1990s (though it was the personality of Sir John's complacent party rather than his own that was the main problem then). Sooner or later—and probably as late as possible—Mr Brown will be spat out by a general election. But, runs the increasingly conventional wisdom, after this week, with voters' trust forfeited, the media derisive and whispering about his leadership under way, he is probably done for already.

He may be. But there are three reasons to think otherwise.

First, Mr Brown has not yet conclusively failed the first test of all prime ministers: the Hippocratic one. Northern Rock may prove financially catastrophic; the lost discs may yet result in inconveniences that upset voters irrevocably. But Mr Brown has not presided over any cast-iron disasters or lethal scandals. This was a dark week, but it was no Black Wednesday.

Second, for all his faults and the virtues of David Cameron, the Tory leader, it is far too soon to conclude that the preference for Mr Cameron evident in recent opinion polls is fixed. The two men have yet to face off in anything resembling normal political circumstances, with no election furore or freakish mishaps. Mr Cameron is not yet the inevitable prime minister that Mr Blair seemed soon after he became Labour leader in 1994; compared with Sir John, Mr Brown has a big parliamentary majority and a relatively united party behind him. All that may change: Mr Cameron's poll lead may stabilise or widen, especially if the economic outlook and public finances deteriorate, as they seem likely to. But even then, Mr Brown could still turn out to be a good prime minister.

Eat up, or no dessert

Political leaders can be successful in two ways, which do not always go together and sometimes even contradict each other: they can win lots of elections, or they can leave their country better off, one way or another, than when they took charge of it. Mr Brown will have less fair circumstances and almost certainly less time than Mr Blair did to change Britain. But beneath the bluster and mishaps, he is showing at least an appetite for taking on some of the most intractable problems of social policy—such as the fact that too many pupils leave school with no qualifications, and that too many people expensively claim incapacity benefit. Probably he will fail to solve them, as Labour has done until now. But he is at least trying. He truly wants to spread opportunity more fairly (all those mute inglorious Himmelfarbs...). He is tentatively but admirably beginning to rebalance Britain's skewed constitution.

Two months ago, when Mr Brown seemed able to turn flood waters into wine, it would have seemed absurd to be thinking in these terms. But now it is worth remembering: there may still be some wholesome meat left in Mr Brown's sausage.

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Economist.com WORLD INTERNATIONAL

Global clubs

When your only weapon is shame

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Illustration by Claudio Munoz

Using its power to ostracise and exclude, the Commonwealth has had sporadic success as a promoter of democracy; other clubs find it harder

Get article background

THERE are some global clubs that do hard business, like waging war or regulating trade. And there is another sort of club, with a large, ill-defined membership, and sensible goals but little power to correct wrongs except through peer pressure.

In a cold, unsentimental world, the second type of club might seem doomed. Given that the consequences of being suspended, or even expelled, from such a group are rarely disastrous—the equivalent, at worst, of being shunned by one's schoolmates—they will surely not deter the planet's worst rogues.

But those big, loose clubs somehow shuffle on—and world figures still devote time and energy to keeping them alive. Take the 53 member states of the Commonwealth, whose leaders will gather this weekend in Uganda's capital, Kampala. Advocates of this giant talking-shop say it got a new wind after the end of the cold war made propagating democracy and the rule of law more feasible, and necessary.

“The special strength of the Commonwealth lies in the combination of the diversity of its members with their shared inheritance in language, culture, and the rule of law.” So said the Harare Declaration, a 1991 document spelling out the values to which the Commonwealth members are supposed to adhere.

Don McKinnon, a New Zealander who has served as secretary-general since 2000, insists that the organisation—with nearly 2 billion people (half Indian) in its domain—has done a decent job of holding governments to their declared values. As proof of its relevance to concrete problems, he cites its promotion of fair trading terms for poor-world farmers. Moreover, he points out, countries are still gagging to join. Having started as an ex-British club, it grew more elastic in 1995 when it admitted ex-Portuguese Mozambique and took in Cameroon, most of which was French.

In Francophone (formerly Belgian) Rwanda, young enthusiasts have been learning cricket as a token of their country's keenness to join the Commonwealth. And in ex-Portuguese Timor-Leste, President José Ramos Horta has pledged that he too will apply. Neither of these bidders would have to leave the groups they already belong to: respectively *la Francophonie* (whose 53 members speak varying levels of French) and a community of eight Portuguese-speaking states. For tiny states with recent memories of horrific

violence, the more clubs the better, it seems. Meanwhile Somaliland, the ex-British part of Somalia, wants to join the Commonwealth as part of a drive to secede from that country's war-torn south.

If many countries want to join, that makes exclusion, or self-exclusion, somewhat more embarrassing. Fed up with being suspended, Zimbabwe's dictatorial leader, Robert Mugabe, stormed out of the Commonwealth in 2003. He said he didn't care—but it was an ugly spectacle.

In the run-up to the Kampala summit, Commonwealth foreign ministers were considering whether to re-suspend Pakistan, one of several members whose relationship with the club has fluctuated sharply. (Another problem member is Fiji, whose latest suspension was decreed in December 2006.) The Commonwealth has a record not only of ostracising miscreants (not always with consistency) but also of readmitting repentant sinners.

If it succeeds as a talking-shop, the reasons may be as much negative as positive. While some members liked the Soviet Union, none has ever been communist (bar Mozambique)—or experienced a total suppression of the separation of powers. And there are more subtle factors: veterans of Commonwealth summitry say the mix of informality and royal glamour is a heady experience for the leaders of small countries who rarely tread the world stage.

None of the above plus points can be claimed by another idealistic and far-flung talking shop, one that extends from Vancouver to Vladivostok: the Organisation for Security and Co-operation in Europe, which comprises America, Canada, all of Europe and the ex-Soviet republics.

As Queen Elizabeth, the head of the Commonwealth, packed her bags for Kampala, Spain's King Juan Carlos went to Vienna to laud the role of the OSCE (now under Spanish chairmanship) and hailed the 56-member group's labours in the service of “peace, prosperity and democracy”.

The OSCE has worthy aims. In places where the value of words like democracy and law has been debased, reinvesting them with meaning is a noble task. But it seemed easier in the euphoric days after the Soviet collapse, when almost every ex-communist state was vying to be a virtuous advocate of human rights.

It was in that atmosphere that the OSCE, on just one occasion, mustered the unity needed to discipline a wayward member: Yugoslavia (by that time reduced to Serbia and Montenegro) was suspended in 1992, and only readmitted in 2000 after the fall of Slobodan Milosevic's tyranny.

Since then, several ex-Soviet republics have become sceptical of the Western idea of human rights and multi-party democracy; but none of these awkward customers is ever likely to be suspended because unanimity would be needed. Russia's relations with the OSCE soured recently after the organisation dropped its plan to send observers to the forthcoming Russian election, on grounds that the Kremlin was limiting their numbers and holding up visas. At a meeting in Madrid next week, OSCE governments will consider awarding the body's rotating chairmanship to Kazakhstan: not the worst human-rights offender in the region but not a paragon of democracy either.

If the Commonwealth half-works as a forum where miscreants can be shamed, that is because its members—in several ways—speak the same language. The OSCE's problem may be that words like freedom and democracy mean one thing in, say, Tashkent and another in Vienna.

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AIDS

WHO's counting?

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AP

At last, some relatively welcome news

The global AIDS epidemic is still bad, but not as bad as it once seemed

ON THE face of things, a fall in the number of people infected with HIV (the virus that causes AIDS) from 39.5m to 33.2m over the course of a single year, as reported in this year's AIDS epidemic update from the World Health Organisation (WHO) and UNAIDS, should be cause for rejoicing. Indeed, it is, for it means there are fewer people to treat, and fewer to pass the infection on, than was previously thought. But the fall is not a real fall. Rather, it is due to a change in the way the size of the epidemic is estimated.

If you factor in that change, the number of infected individuals has actually risen since last year, by 500,000. Yet even that is not necessarily bad news in the paradoxical world of AIDS. As treatment programmes are rolled out around the world, death rates are falling. According to the revised figures, the lethal peak, of 2.2m a year, was in 2005. Now the figure is 2.1m. Since the only way for an infected person to drop out of the statistics in reality (as opposed to by sleight of statistical hand) is for him to die, such increased survivorship inevitably pushes up the total size of the epidemic.

The best news of all, however, is that the new figures confirm what had previously been suspected—that the epidemic has peaked. The highest annual number of new infections around the world was 3.4m in 1998. That figure has now fallen to 2.5m.

Both the change in the death rate and the change in the infection rate are partly a consequence of the natural flow and ebb of any epidemic infection. But they are also a reflection of the hard graft of public-health workers in many countries, who have persuaded millions of people to modify or abandon risky behaviour, such as having unprotected sex, as they have also created the medical infrastructure needed to distribute anti-retroviral drugs that can keep symptoms at bay in those who do become infected.

The revision of the figures is mainly a result of better data-collection methods, particularly in India (which accounts for half the downward revision) and five African countries (which account for another fifth). In India many more sampling points have been established, and in all countries better survey methods, relying on surveyors knocking on doors rather than asking questions at clinics, have gathered data from more representative samples.

Sceptics will feel vindicated by the revision. They have suspected for a while that the older survey methods were biased, and that the inflation thus produced was tolerated because it helped twang the heart-strings of potential donors. However, the structures for collecting and distributing money to combat AIDS are now well established, and accurate data are crucial if that money is not to be misdirected. The new information also means that the goal of treatment for all who need it will be easier and cheaper to

achieve. The WHO and UNAIDS are planning to publish a report on the matter early next year, but Paul De Lay, UNAIDS's director of evidence, monitoring and policy, says that the financial requirements for 2010 will probably be about 5% less than previously estimated, and that by 2015 that figure will have risen to 10%. Good news for everyone, then, donors and sufferers alike.

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The sound of success

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Rex Features

Austria has had some lucky breaks and has used them with brio, says Barbara Beck (interviewed here). But what should it do for an encore?

HEISS umfehdet, wild umstritten
Liegst dem Erdteil du inmitten,
Einem starken Herzen gleich
(Hotly fought over, fiercely contested,
You lie at the centre of the continent,
Like a strong heart).

The words of the second verse of Austria's post-war national anthem, set to music that may or may not be by Mozart, at first seemed to miss the point. They were written in 1947 by an Austrian poet, Paula von Preradovic, because the old anthem had been pinched by the Germans. They would have been right for the pre-1918 Habsburg empire, but the world had just been divided by the iron curtain, leaving little Austria squeezed up against the Western side of the border with the communist East. It was at the centre of nowhere.

The anthem's prophecy took 40 years to come true, but it now seems spot on. The end of the cold war in 1989 and the recent entry of many of Austria's eastern and southern neighbours into the European Union have put the country back at the heart of the continent. That has proved an excellent place to be.

Austria has benefited more from Europe's opening to the east than any of the other older EU members, in several ways. First, its trade with central and eastern Europe (CEE) has soared over the past decade and a half, helping to reduce its trade deficit to manageable proportions. Second, and more important, Austria's stock of direct investment in central and eastern Europe zoomed from next to nothing in the early 1990s to nearly €19 billion ($28 billion) in 2004, equivalent to 8% of Austria's GDP (see chart 1).

The kind of business Austria is doing in the region has also changed. Whereas a decade ago much of its investment was concentrated on manufacturing, now the biggest chunk goes on financial intermediation, property and services, suggesting that Austrian firms are doing lots of new kinds of business there. Austrian banks, in particular, are spreading their wings to the east (of which more later).

All this has meant higher growth and employment in Austria itself than would otherwise have been possible. In a paper published last year, Fritz Breuss of Austria's WIFO economic research institute attempted to quantify the effects on the Austrian economy of the eastern opening, together with those of Austria's EU entry in 1995, EU economic and monetary union in 1999 and the entry of ten new EU members in 2004. Some of the effects overlap, but in broad terms Mr Breuss reckons that in the past decade and a half the opening to the east has boosted Austria's real GDP by around 3.5%; that over the past ten years Austria's accession to the EU and its membership of the euro zone have added an extra 4.5%; and that over the next ten years the 2004 EU enlargement will yield a further 2%. The future gains may turn out to be bigger, because the new EU members are growing faster than the older ones. Further boosts might come from Bulgaria and Romania, which joined at the beginning of this year, and perhaps from other Balkan countries if and when they get in.

Why has Austria been so much more successful in the region than other west European countries? It helped to be next door, even though after nearly half a century of separation the transport links across the old East-West borders were in a sorry state. It also made a difference that Germany, a natural competitor, was preoccupied with its own unification. Austrians reckon that "not being Germany" helped because their big neighbour can seem overbearing to smaller countries (including, sometimes, to Austria).

But probably the biggest part of the explanation lies in Austria's own extraordinary history. For most of the past millennium it was a much bigger and more powerful country than it is now, as well as a more multilingual and multicultural one. Vienna still has the feel of an imperial capital, much grander than seems appropriate for a country with a mere 8m people. It is impossible to understand Austria today without knowing something of its past.

During 640 years of Habsburg rule, from 1278 to 1918, the country waxed and waned as its borders shifted back and forth across Europe. There were plenty of battles, but also acquisitions by other means: some Habsburgs married well. The famous saying "Bella gerant alii, tu, felix Austria, nube (let others wage war; you, fortunate Austria, marry)" referred to the marital habits of the 15th-century Holy Roman Emperor Maximilian I and his family.

In 1867 the emperor of Austria also became king of Hungary, in a dual monarchy known as "k.u.k." (*kaiserlich und königlich*, or imperial and royal). In his book "The Man Without Qualities", Robert Musil, an early-20th-century Austrian writer, satirised the country as "Kakanien", a place stuck in a time warp, redolent of bureaucracy and twirly moustaches. Mention of Kakanien still makes Austrians smile.

Austria's history reached its nadir in the first half of the 20th century. The treaty of St Germain after the first world war reduced it from a cosmopolitan empire of 50m to a small, German-speaking republic of 6.5m. The shock was immense, and was soon to be amplified by the Great Depression. The resulting political turmoil led to the catastrophic *Anschluss* (absorption into Germany), which wiped Austria off the map and turned it into a German province, the Ostmark (see article).

After the second world war, having regained its sovereignty under its 1955 state treaty with the Allies, Austria became more reconciled to its reduced role in the world. Although its links with its former empire had been weakened during the Nazi period—and became even more tenuous during the cold war—it continued to take a special interest in its eastern and southern neighbours and thought of itself as a mediator between East and West.

The people on the other side of the border remain close cousins. Vienna's telephone book is full of names that hail from farther south and east, and many Austrian citizens still speak the languages that go with the names. It is said that half of them have relatives in the countries of the old Habsburg empire. They share the same culture and find it easy to do business together. They work just as hard as the Germans or the Swiss, but they are also more relaxed and less pernickety.

Count your blessings

For the moment, the main difference between Austria and its neighbours to the south and east is that it is vastly richer. In fact, as the fourth-richest country in the EU measured by GDP per person at purchasing-power parity, it is better off than most of its western neighbours too. In recent years it has been growing faster than many of them, and it is set to maintain that lead for the next few years.

Twenty-first-century Austria seems comfortable in its skin. It has come to terms with being small and is beginning to see the advantages. Within the EU it may not carry the clout of a Germany or a France, but there are plenty of other small members with which it can make common cause. Its neutrality, forced on it after the second world war, has proved not only convenient but sufficiently flexible to suit changing circumstances. It generally gets on well with its western neighbours. Even an old argument over South Tyrol, a German-speaking province that was handed to Italy after the first world war, has been resolved. Relations with its eastern neighbours are not only mostly cordial but have also proved highly profitable.

A predominantly Catholic country, Austria wears its faith lightly. When the pope came to visit in September, the crowds were welcoming but not ecstatic. Some commentators described him as “cool”. Austria's stance on social issues is relatively liberal: abortion and homosexuality were legalised in the 1970s, though gay marriage has yet to arrive. The country is proud of the fact that it recognised Islam as an official religion back in 1912.

Austria's system of proportional representation, which tends to produce coalition governments and often grand coalitions, may lack the cut and thrust of a first-past-the-post system, but it appears to reflect the wishes of its people. Its tradition of “social partnership” between employers and employees may seem opaque, but it has ensured a long period of social peace and moderate pay settlements. Its welfare state, though not as lavish as those of the Nordic countries, keeps its citizens fairly comfortable in adversity and allows many to achieve their ambition of “retiring well” (on 90% of previous net income for the average earner). The once excellent education system is showing signs of wear and tear, but remains good in parts.

Trains, trams and buses generally run on time. The country's beautiful scenery of mountains, lakes and forests, looked after by an environmentally conscious people, offers a high quality of outdoor life, as well as bringing in lots of well-heeled tourists. And Austrians have no need to worry about nuclear mishaps on

their soil: the only nuclear power plant, at Zwentendorf, was mothballed nearly 30 years ago. (Unfortunately neighbouring countries such as the Czech Republic have failed to take similar precautions.)

Indoor life benefits from generous state spending on culture, not just on Mozart and the Johann Strausses but experimental stuff as well. On a more quotidian level, Austrians are among Europe's most avid newspaper readers (though some of the mass-circulation press is unedifying).

Does all this make Austria an “island of the blessed”? Coined in 1971 by an earlier pope, Paul VI, this has become a—slightly ironic—catchphrase for everything that is good about the country: affluence, social justice, a harmonious society. Those blessings remain, but, as this special report will argue, Austrians should not take them for granted. In an era of globalisation there is no such thing as an island: a subprime crisis in America or a commodity boom set off by China will reverberate in the most remote Alpine valley, and new competitors pop up from nowhere. Austria needs to keep working at its luck. That is something its politicians should bear in mind.

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Remember, remember

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What did you do during the war?

NOT all of Austria's history was glorious. The birth in 1918 of the post-Habsburg, downsized, monoglot Austria of the First Republic inspired little enthusiasm among its people, and its democracy soon proved fragile. In 1933 Engelbert Dollfuss, chancellor of a right-of-centre government, dissolved parliament. The following year the army put down Social Democratic protests in a brief but bloody civil war. Soon afterwards Dollfuss was assassinated during an abortive putsch by Austrian Nazis. In March 1938 German troops moved into Austria unopposed, Hitler staged a triumphant return to the country of his birth, and in the subsequent referendum an inconceivable 99% of the population voted for *Anschluss* to Germany. Virulent anti-Semitism became *de rigueur*, and many Jews who had not managed to emigrate were sent off to the concentration camps.

Were the Austrians willing partners in all this or was their hand forced? The four Allies' Moscow Declaration of 1943 described Austria as the first victim of Hitler's policy of aggression and promised to reinstate it as a free and independent country. After 1945 Austria eagerly seized on the “victim” formula, which was retained in its 1955 state treaty to re-establish its sovereignty. Immediately after the war many Nazis were purged and some sentenced to death, but an amnesty was granted in 1948. By then the cold war had become the dominant political reality and the Nazi period was beginning to recede into the background.

It was recalled to mind by the “Waldheim affair” in 1986. Kurt Waldheim was a former Austrian foreign minister who served as secretary-general of the United Nations in 1972-82. When four years later he ran for the Austrian presidency, journalists started digging and discovered that his recently published autobiography gave a highly misleading account of his wartime service with the *Wehrmacht*. The Austrians elected him president anyway, but during his six years in office he did not receive a single state invitation from a Western government. Subsequent inquiries produced no evidence that Waldheim had actually taken part in any war crimes, but cast doubt on his claim that he had not known what was going on. His death earlier this year, aged 88, revived uncomfortable memories.

By the end of Waldheim's presidency Austria had become readier to face the past. In 1991 Franz Vranitzky, a long-serving Social Democratic chancellor, acknowledged in a speech in parliament that his country bore some of the responsibility for the second world war and offered an apology.

By the time Austria joined the EU in 1995, the wartime past had more or less faded from memory. But the other EU governments feared a resurgence of right-wing extremism in 1999 when the far-right Freedom Party, led by Jörg Haider, bagged nearly 27% of the vote in an election and entered a coalition with the centre-right Austrian People's Party. For over six months they ostracised Austria before conceding that there was no legal basis for the boycott and resuming normal business. The Freedom Party lost much of its support at the following election and subsequently split.

A way of saying sorry

In 1995 the Austrian government marked the 50th anniversary of the birth of the Second Republic by setting up a national fund for Austrian victims of the Nazi regime. The sums offered, though not large, were an acknowledgment of the wrong that had been done. The fund has received over 32,000 applications and paid out €150m. Two other funds offer, respectively, reparation for loss of tenancy rights and of property. Hannah Lessing, the national fund's general secretary, has no personal memories of the period, but her father escaped just in time and her grandmother died in Auschwitz. Of about 200,000 Jews who lived in Austria in the 1930s, more than half emigrated ahead of the *Anschluss* and 65,000 perished. The total in Austria now is only about 10,000.

Ms Lessing says that present-day Austrians are no more racist than other people and that the number of neo-Nazis is tiny. (Holocaust denial is a crime, as it is in Germany.) But she feels there is a danger that

the lessons of the past may be forgotten. A good thing, then, that since 1988 teaching about the Holocaust has been obligatory at Austrian schools, and that all schoolchildren must visit the former concentration camp at Mauthausen.

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Sleeping with the enemy

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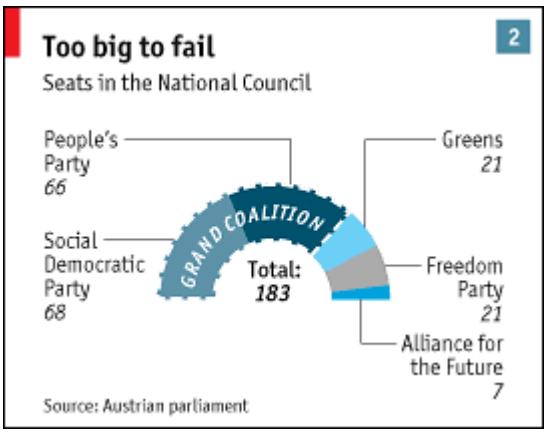
Austria's way of resolving political conflicts

THEY call it a “consensus democracy” or “democracy by negotiation”, and it is tailor-made for their particular needs. When Austria's Second Republic was born after the second world war, the country was desperate to prevent a recurrence of the deep political divisions that, in 1934, had led to a bloody civil war. Thanks to that fear of adversarial politics, 11 of Austria's 20 post-war governments have been “grand coalitions” of the two big parties—the centre-right Austrian People's Party (“Blacks”) and the centre-left Social Democratic Party (“Reds”).

After a break starting in 2000, during which the Blacks controversially governed in coalition with the far-right Freedom Party (“Blues”), the most recent election in October 2006 produced yet another grand coalition (see chart 2) after the Social Democrats, led by Alfred Gusenbauer, unexpectedly finished slightly ahead of the People's Party. Mr Gusenbauer, a 47-year-old career politician, duly bagged the job of chancellor he had always wanted, but had to cede a number of other key posts—including finance, economy and foreign affairs—to the People's Party. Some supporters accused him of failing to carry out election promises, such as cancelling Austria's order for Eurofighter planes and rescinding recently introduced university tuition fees, but he had little choice.

So far this has proved an ill-tempered match, with constant bickering between the partners. Even so, they are likely to stick together for the whole of the current electoral term, which ends in 2010. Neither wants to be responsible for breaking up the coalition, for fear of something worse.



Coalitions are rarely easy. The previous government, headed by the People's Party's Wolfgang Schüssel, faced a different set of problems. In the 1999 election the Blues, led by the controversial Jörg Haider, enjoyed a triumph after a xenophobic campaign, capturing nearly 27% of the vote, almost the same as the Blacks. The People's Party eventually formed a coalition with Mr Haider's outfit, provoking huge protests at home and a cold shoulder for Austria from other EU countries for a few months (see article). Mr Haider went back to his home in Carinthia, a deeply conservative region where he is now state premier.

The Black-Blue coalition fell apart after only a couple of years, but was reinstated after a snap election in 2002 at which Mr Schüssel's strategy was vindicated. His party's share of the vote rose steeply whereas that of the Freedom Party plummeted. In 2005 the Blues weakened themselves further by splitting into a mainstream wing and a more extreme fringe. They now seem consigned to minor-party status (unlike in Switzerland, where in last month's elections the right-wing Swiss People's Party won 29% of the vote).

As the newly dominant partner in Austria's coalition, the People's Party was left free to introduce a number of overdue reforms, including a reorganisation of the state pension scheme, a shake-up of the universities and a cut in the corporate-tax rate from 34% to 25%. Most polls ahead of last year's election suggested that it would be rewarded with a bigger share of the vote. But many Austrians felt that the Schüssel government was “socially cold”, ie, too free-market-oriented, and voted Social Democrat instead—so the country ended up with yet another grand coalition.

Something for everyone

The fact is that most Austrians are perfectly happy with that. They are used to a system in which power and jobs are shared out to reflect a wide range of opinion. For most of the post-war period an important element of Austrian politics has been the *Proporz*, a form of “jobs for the boys” in which posts and

contracts in the public sector and state-owned industry were divvied up among supporters of the two big parties. That meant they had to work closely together, but were also able to keep an eye on each other. In a small country, everybody knows everybody else anyway, but belonging to a party was often a great help in advancing one's career, which explains why party membership in Austria, at 15% of the adult population, is among the highest in the West. The *Proporz* now seems to be somewhat in retreat, not least because most state industries have been privatised so there are fewer jobs to be handed out; but it has far from disappeared.

The same sort of thing happens in the nine states in Austria's federal system. Most of them give all parties of any size the right to take part in the state government, with posts handed out in proportion to their share of the vote. This makes it hard to form governments, but at least nobody can complain about having been left out.

EPA

Gusenbauer got what he wanted

Austrians are good at striking compromises. Hannes Androsch, a former vice-chancellor turned businessman, explains that in Germany the word *grundsätzlich* (in principle) means “no”; in Austria it means “yes”. Disagreements are resolved by sitting round a table and talking until everybody has got a bit of what he wants.

The same idea is enshrined in Austria's post-war system of “social partnership”, a mechanism through which government, employers and employees co-operate over pay and economic policy. It is seen almost as a second arm of government. The main bodies involved are chambers of commerce and workers' chambers, both of which have compulsory membership and elected representatives. Trade unions also play a part but have lost clout in recent years, and have been damaged by a corruption scandal over BAWAG, a bank they used to own but had to sell.

Corporatism may be out of fashion elsewhere, but in Austria it seems to deliver results. Strikes are extremely rare, pay settlements tend to be reasonable and unit labour costs are forever dropping. Growth is higher and unemployment lower than in comparable countries. Industrialists cite the system as a source of competitive advantage; labour representatives see it as a way of achieving social justice. For all that its demise is being regularly predicted, there seems to be plenty of life left in it.

Isn't this all a bit too cosy? The consensus model may not be corrupt (in fact, Austria comes off well in international comparisons of corruption), but it is certainly not transparent. People who are not ready or able to work through the entrenched institutions lose out. And because it takes time to get everyone to agree, change is necessarily slow, perhaps too slow. Besides, many of the rules that govern business are no longer made in Vienna but in Brussels or farther afield, so there is a limit to what can be decided behind Austria's closed doors.

And those grand coalitions? Austrian voters may not mind them, but many politicians long for a system that produces clearer majorities. Germany next door, with a different system of proportional representation, has mostly avoided grand coalitions until recently and seems uncomfortable with the present one. Austria has produced a constant stream of proposals to reform its voting system, but the smaller parties tend to resist them. The latest idea is for a *minderheitsfreundliches Mehrheitswahlrecht*, a first-past-the-post system that takes account of the interests of minorities. But it is hard to believe that anything will come of it: too many people have too much to lose.

Agreement has been reached, though, on a few other, less radical changes to the political system. Starting with the next election in 2010, the standard term of government will increase from four to five years; postal voting will become available to everyone; and the active voting age will come down from 18 to a surprising 16.

That may be a slight help to the Greens, who in the 2006 election garnered over 11% of the poll, a little more than the Freedom Party. Their voters are predominantly middle-class, prosperous, environmentally concerned—and younger than supporters of other parties. The Greens' boss, Alexander Van der Bellen, a mild-mannered economics professor, thinks there is a chance that his party could enter the government after the next election, as a potential coalition partner for either of the big parties. That would be a novel feature in the Austrian political landscape.

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Ungrateful Europeans

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From The Economist print edition

Austrians don't love the EU, but nor will they leave it

THE sign on the door reads “Ministry for European and International Affairs”. When Ursula Plassnik became its boss three years ago, it was called “Ministry for Foreign Affairs”. She changed the name because she thought it sounded as though foreign policy was something quite separate from the domestic variety. “We are part and parcel of Europe and the world,” she says. “We should feel ownership as stakeholders, not onlookers.”

Austria has been a member of the European Union for less than 13 years and has suffered a few hiccups since it joined, but is now comfortably settled in. In May 2005 its parliament approved the original version of the new EU constitution with just one dissenting vote (only to see it ditched by the French and Dutch referendums shortly afterwards). Getting approval for the scaled-down treaty revision agreed on at the EU summit last month should be easy: Austria's politicians know that membership has been good for the country.

Promoting the EU by the plateful

Yet for decades it seemed inconceivable that Austria would ever join the European club. Under its 1955 state treaty, it had to promise to abstain from any direct or indirect political or economic union with Germany. West Germany was a member of what in 1957 became the European Economic Community, so Austria could not be. It had to look for other ways of getting access to Europe's huge market without the political obligations of EEC membership. In 1960 it became a founder member of the European Free Trade Association (EFTA), along with Britain, Denmark, Norway, Portugal, Sweden and Switzerland.

Some of the original EFTA members subsequently joined the grander club, which left EFTA looking rather naked. When in 1986 the European Community decided to push for a single internal market to promote the free movement of people, goods, services and capital, the remaining EFTA countries set up the European Economic Area in the hope of sharing some of the benefits. The agreement eventually took effect in 1994, but by then Austria was about to move on. The political changes on the other side of the iron curtain had made it possible to start thinking about membership of the EC itself (although the Russians were still not keen on the idea).

Austria, for its part, had become keener because it badly needed the economic boost it thought entry would provide. Its nationalised industries were in crisis and growth was sagging. It put in an application in 1989, got the terms of entry approved by a two-thirds majority in a referendum in 1994 and joined at the start of 1995, together with Finland and Sweden. As one of the richer members, it also qualified to join the new club-within-a-club launched in 1999, Europe's Economic and Monetary Union—though it struggled to cut its public spending to meet the Maastricht criteria for entry. In 2002 it swapped its schillings for euro notes and coins.

Rich rewards

The benefits to Austria of EU membership are hard to quantify precisely, but according to various educated guesses they are substantial. The study by Fritz Breuss mentioned earlier suggests that over the past ten years membership brought extra GDP growth totalling about 4.5%. Another study, by Franz Nauschnigg of the Austrian Society for European Policy, compared Austria with Switzerland—neighbouring countries with similar economies, one inside the EU, the other outside—and found that GDP

growth in Austria between 1990 and 2006 was 28% higher than in its Alpine neighbour. Not all of the difference can be explained by EU entry—Austria had a lot of catching up to do—but there is little doubt that growth would have been slower outside the club.

And there is more to come. The lifting of the iron curtain and, more recently, the arrival in the EU of new members in central and eastern Europe have provided Austrian businesses with a remarkable opportunity on their doorstep which they have eagerly seized. Austrian firms, particularly banks and other financial-service providers, have piled into the region to take advantage of these new markets (see article). Foreign companies too are increasingly using Vienna as a base for their operations in the new member states.

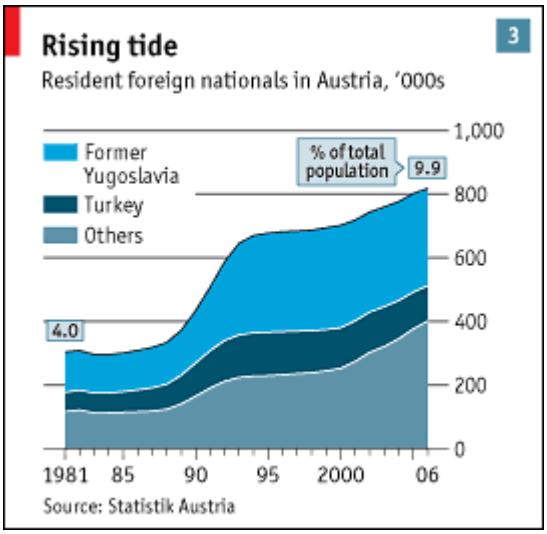
No wonder Austrian business is all in favour of the EU. But a slick advertising campaign launched by seven large companies to sell the club to the man in the street ("Schau über den Tellerrand"—look beyond the edge of the plate) fell on deaf ears. Public opinion in Austria is more Eurosceptic than in any other EU country except semi-detached Britain. In the most recent Eurobarometer opinion poll in spring this year, only 36% of Austrians saw their country's EU membership as a good thing and 25% thought it was a downright bad thing. Opinion on whether their country had benefited from membership was almost evenly split, with 44% saying it had and 43% it had not. The antis complain that Austria is too small to make much of an impression on the EU, which they see as being run by and for the benefit of the biggest members. And whether pro or anti, Austrians are still cross about that EU boycott in 2000 over the inclusion of Mr Haider's party in their government.

Austrian Europhiles insist that although their countrymen may not love the EU, they would not dream of leaving it. A long-running poll that puts the choice in simple terms—should Austria remain in the EU or pull out again?—has fairly consistently produced a two-thirds majority in favour of staying in—much the same proportion that voted "yes" to entry in the 1994 referendum.

A closer analysis of how opinions divide shows that the level of support for EU membership tends to reflect people's economic interests. Well-educated and highly qualified Austrians are in favour because they see lots of business opportunities in the new member countries and welcome foreign workers in Austria to ease labour shortages. Those near the bottom of the social scale are against because they worry that foreign workers will take their jobs.

Austria likes to think of itself as a place that opens its doors to outsiders. It took in more than a million ethnic Germans from central and eastern Europe in 1945-50, as well as hundreds of thousands of refugees from Hungary and Czechoslovakia after the troubles there in 1956 and 1968 respectively. More recently it has accepted many asylum-seekers from flashpoints around the world.

But although foreign nationals now make up nearly 10% of its population (see chart 3), not counting illegal immigrants who by definition are hard to quantify, its treatment of foreigners has sometimes been less than generous. Unlike some other EU countries it has offered few voting rights to resident foreigners, and it did not give unrestricted access to workers from the central and eastern European countries that joined in 2004. Skilled people from those countries will now be admitted from next year, but only to ease an acute shortage in Austria. The unskilled may have to wait until the EU's deadline of 2011, when all restrictions must go.



What about further enlargement? "My agenda is the Balkans," says Ms Plassnik. "One day Belgrade and Pristina will be members of the EU." She considers the resolution of Kosovo's status "a maturity test for European foreign policy". And farther south-east still? Turkey now realises that it has to change if it wants to join the EU, she says. She does not exclude the possibility that it might become a member one day, but "a tailor-made EU-Turkish relationship might be an alternative." Most Austrians are bitterly opposed to Turkish entry. The memory of the Ottomans' siege of Vienna in 1683 lingers on.

A more recent episode of Austria's past also reverberates in the present. When Austria signed its 1955 state treaty, it had to agree, at Russia's request, to become permanently neutral. That suited the Austrians too. It did not stop them from aligning themselves with the West, but it ruled out joining NATO.

At about 0.8% of GDP, Austria spends quite a modest amount on defence, and compulsory military service for its young men is now a mere six months. Neutrality is supported by more than 70% of the population and has become part of modern Austria's identity as a small, peaceful and prosperous country.

Carry on in neutral

Critics say that Austria has elevated neutrality to a creed, claiming that it will keep the country out of harm's way but all the while free-riding on NATO's tanks. Many Austrians had even become convinced that their country's neutral status would protect them from the threat of terrorism—until in September several Austrian Muslims were arrested in Vienna on suspicion of hatching a terrorist plot.

What is clear is that the meaning of neutrality has changed since the end of the East-West conflict. Although NATO membership is still taboo, Austria does take part in the organisation's “Partnership for Peace” programme and allows NATO peacekeeping forces to use its airspace. It also takes part in UN peacekeeping missions. More importantly, it has signed up to the EU's joint defence policy, which will involve a sizeable European force.

To jettison its neutrality, Austria would have to find a two-thirds majority in its parliament and do a fair bit of explaining abroad. Redefining it goes a long way at a much lower political cost.

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Mustn't grumble

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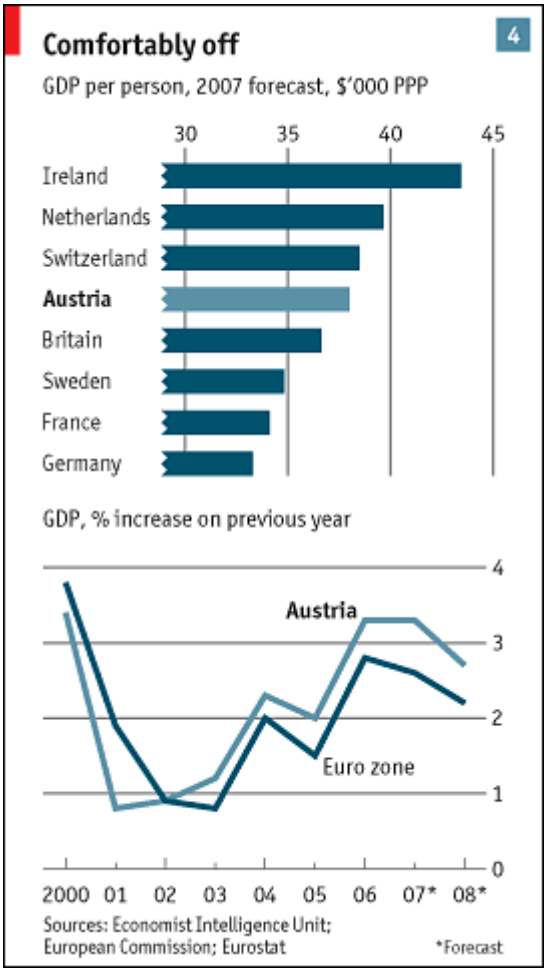
The economy is having an excellent run and business is booming. Can it last?



AUSTRIANS love to complain, but when it comes to their economy even they admit that they are currently grumbling at a high level. After years of catching up with their wealthy European neighbours, they seem to have arrived: leaving aside a handful of countries like Switzerland, Norway and the newly rich Ireland, Austria is up there with the best of them (and, gratifyingly, slightly ahead of Germany). For most of the past ten years average GDP growth, at 2.3% a year, has been faster than the EU's. Last year's solid 3.3% could be matched this year, though next year things are likely to slow down a bit (see chart 4).

Not only is Austria rich and getting richer, but its wealth is reasonably well spread. According to the OECD, the Gini coefficient of income distribution in 2000 was about 25, roughly on a par with Scandinavia, against an OECD average of 31 (the higher, the less equal). Some of Austria's nine federal states are better off than others, with Vienna getting most of the cream, but the differences are not vast. And Europe's opening to the east has helped border regions that previously found themselves, as one banker puts it, “at the end of the world”.

Inflation, at 1.4%, and unemployment, at 4.2%, are both enviably low by European standards. The budget deficit, at 1% this year (on the Maastricht definition), is already modest and will continue to fall, thanks to relatively buoyant tax revenues. Pay settlements are generally reasonable, helped by the system of “social partnership”. In three of the past five years, including 2007, net real incomes from employment have barely budged even though the economy has been growing steadily, yet workers are not mounting the barricades (though nor are they throwing their money around). Austria's schilling was pegged to the Deutschmark for many years, keeping producers on their toes, and since 1999 membership of the euro zone has had a similar effect. As a result of all this, unit labour costs in manufacturing in euro terms in the ten years to 2005 fell by an astonishing 38%. Over the same period Germany managed only a 7% drop. (In services, however, Austria's productivity record is much less impressive.)

Being small, Austria has traditionally been an open, export-oriented country, and in the past few decades it has become the very model of internationalisation. Unlike Switzerland, it has no really big multinational companies and only a few well-known international brands (such as Swarovski, an upmarket maker of crystal jewellery and trinkets, and Red Bull, a fashionable energy drink). Its strength lies in its small and medium-sized companies, many of them family-owned, that make highly specialised, top-quality products and export them all over the world.

In the economic globalisation index produced by the Swiss Institute for Business-Cycle Research (KOF), which measures the free flow of goods, capital and services across countries, Austria moved up from 29th (out of 97 countries) in 1970 to 7th (out of 109) in 2004, well above the average for the EU 15 and the OECD countries. The downside of this openness is that Austria depends heavily on the economic health of its trade partners. Germany alone takes 32% of its exports, so the economic chill there a few years ago had a knock-on effect in Austria—which has made the recent German recovery all the more welcome.

A golden opportunity

But the favourite new playground of Austria's export-oriented firms is central and eastern Europe. Thanks to their cultural and historic links with the region, Austrian businesses were able to establish themselves quickly in the new markets, securing a “first-mover” advantage that may prove quite durable. Many of the countries in the region are small, but for Austria's small firms the extra business they bring represents a big net addition. And most of them (except Slovenia and the Czech Republic, which are already relatively rich) still have many years of catching up ahead of them, so both their economies as a whole and some of the markets within them are likely to grow much faster than their west European equivalents.

Some of the most lucrative markets have opened up in financial services. According to an analysis by Austria's central bank, foreign firms have secured around 70% of the banking market in the region, and two of the top three international banking groups that operate there are Austrian. The market leader is Milan-based UniCredit, which also has an Austrian component (Bank Austria). Number two is Erste Bank, Austria's biggest bank. It was later than some of its rivals to arrive in the region (in 2000), but has since snapped up ten banks and accumulated a total of about 16m customers there. Its biggest transaction to date was the purchase in 2005 of a 62% stake in Banca Comerciala Romana, Romania's largest bank, with 2.8m customers.

Erste's boss, Andreas Treichl, says there are still acquisitions to be made and plenty of new business to be developed: for example, customers in the region have been so busy borrowing that they have barely started to think about saving and investing. He reckons it will take 20 or 25 years for these countries to catch up, but that some of them could eventually overtake older EU members such as Portugal and Greece. In the meantime they will be growing a lot faster than the rest of Europe—and as they grow, Austria will benefit.

Raiffeisen International, the quoted arm of Raiffeisen Zentralbank, has an only slightly smaller balance sheet than Erste in the region, and it is growing even faster. Walter Rothensteiner, the group's director-general, tried to buy market share in the region as quickly as possible, starting in 2000. The bank now has 13m customers there, against just 1.7m in Austria. People in these new markets have literally been queuing up to open accounts, he says, so they can take out loans for cars and other consumer goods.

Raiffeisen started off by setting up new banks from scratch, wary of taking over existing ones for fear of finding skeletons in their cupboards; but it is now also buying up existing banks. Mr Rothensteiner does not think there is much left to take over, which will help to keep out other foreign banks. Austria's historical and family connections in the region also count for a lot, and Vienna's accessibility is good for keeping vital personal contacts going. Most importantly, he says, Austrians understand their eastern neighbours' easy-going mentality. He notes that Swiss banks have kept out of the region.

For the moment the bonanza shows no sign of slowing. According to Raiffeisen's research arm, the combined balance sheet of the banking sector in central and eastern Europe last year grew by 28%, to €1.1 trillion. By the end of 2011 it is expected to reach €2.5 trillion, and by 2016 it could double again. The biggest growth will be in retail banking. Total retail credit in central and eastern Europe last year averaged less than 18% of GDP, against about 54% in the euro zone, so the potential is vast. The market is also extremely profitable. According to Austria's central bank, in 2005 the subsidiaries of Austria's banks in central and eastern Europe made up 16% of their consolidated balance-sheet total, but about 35% of their profits. Austrian bankers say they need to charge a bigger risk premium in these markets. They may also be making hay while the sun shines.

Nor is it just Austrian bankers who are chasing opportunities in central and eastern Europe. Boris Nemsic, the boss of Telekom Austria, the incumbent telecoms company, is scouring neighbouring countries for mobile-phone acquisitions. Austria, he points out, has the lowest mobile-phone prices in Europe and its market is saturated, so any growth has to come from abroad. By targeting smaller neighbours to the south-east and east, Mr Nemsic's firm, which went public in 2000, has expanded its market from 8m potential customers in Austria (including babies and centenarians) to 44m. The actual number of subscribers is currently 11m and rising: Telekom Austria has recently bought MDC, a mobile-phone group in Belarus, and is still looking for further acquisitions.

Moreover, a number of foreign companies are now using Austria as a base for their operations in central and eastern Europe. Brigitte Ederer, CEO of Siemens Austria, the country's leading technology and infrastructure company, explains that as a rule the German company's foreign operations are controlled from its headquarters in Munich. But in the mid-1990s the German bosses decided that it was too difficult

to keep an eye on the company's fragmented activities in the region from there, so they transferred overall responsibility for eight of the countries to the subsidiary in Vienna, closer to the action and better suited to what Ms Ederer describes as the “small-scale grind” of this business.

Not all Austrian efforts to do business in the region have gone without a hitch. Earlier this year OMV, a big Austrian energy company, increased its stake in Mol, Hungary's national energy champion, and subsequently launched an informal takeover bid to create Europe's fourth-biggest refinery group after Total, Exxon Mobil and Royal Dutch Shell. But Mol rejected the offer, backed by the Hungarian government, which has since passed a law to make it harder for foreign firms to take over “strategic” companies. The European Commission is threatening legal action against the Hungarians' protectionism. OMV is keeping its fingers crossed.

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A very superior rustbelt

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Who says heavy industry has had its day?

THE happiest day in his life, says Wolfgang Eder, was August 31st 2005. That was when the state of Austria sold its last remaining share in Voestalpine, the steel company of which he is boss. Until the mid-1980s the company had been entirely state-owned, but when the government decided to privatise some of the country's nationalised industries, Voestalpine, with a turnover of about €2 billion, seemed almost too far gone to bother with. From 1985 onwards the firm was extensively restructured, McKinsey was called in twice and more than two-thirds of the 90,000 staff lost their jobs.

In June this year Voestalpine reported revenues for the financial year 2006-07 of €7.05 billion, 13% up on the previous year. Profits, at €765m, were 45% up and the shares, at €56.34, had reached an all-time high (since briefly topped). The firm was also poised to take over Böhler-Uddeholm, a successful special-steel company, thus boosting its turnover by 45% (and saving Böhler-Uddeholm from the attentions of a British private-equity fund). For an outfit that 20 years ago was teetering on the brink of bankruptcy, that was quite a turnaround. How was it done?

What made the difference, says Mr Eder, was the absence of politics and the ability to run the company on commercial criteria. In the bad old state-owned days politicians told it what to produce and the top management was picked under the *Proporz* system. In the early 1980s, the Social Democratic government of Bruno Kreisky thought it was far better for the firm to lose money than to lose jobs, so no one was sacked.

These days staff numbers are down to about 25,000, not counting Böhler-Uddeholm, but the people of Linz, where the company is based, still see it as an excellent employer. Voest has an employee share-ownership scheme in which over 10% of its shares are tucked away (and which also serves as a handy poison pill to discourage potential bidders). Linz itself is a lot greener and less polluted than it used to be, and is due to become European City of Culture in 2009.

Brain, not brawn

In the Linz steel plant, clean as a whistle and done up in a colour scheme recommended by a *feng shui* expert, there is hardly anybody to be seen. The few workers on duty keep an eye on progress from glassed-in observation posts above the shop floor, watching multiple computer screens. Voestalpine does not make commodity steel but occupies various high-end niches: top-quality steel, railway systems, steel sections and sophisticated automotive products, mostly made to order. With Böhler-Uddeholm, a market leader in very fancy special steels, it has now acquired a further niche player.

Like other Austrian firms, Voestalpine has been doing a lot of business in central and eastern Europe since the iron curtain was lifted. It is the only big maker of high-end steel products within a 500km radius of Linz and has become the biggest supplier in these new markets. Demand in the region for cars and other consumer goods is soaring, but the company has no plans to produce any steel there. Mr Eder thinks buying communist-era steelworks could have entailed huge legacy problems, and he has plenty of capacity in Linz to supply whatever is needed. Wages next door may be only a quarter of what they are in Austria, but he reckons his workers are worth the money, and his unit labour costs are still dropping. As long as industry concentrates on the quality end of the market, he argues, it has a good future in Austria.

Manufacturing accounts for 19% of value added in Austria's economy, which makes it more of an “industrial” country than, say, Britain or America (both at 13%). That is all to the good, say many of the country's big bosses. According to Veit Sorger, president of the Federation of Austrian Industry, “one in two Austrian jobs, directly or indirectly, depends on industry.” He foresees a “new industrial era” in which success will come from lots of R&D and constant innovation.

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Be happy, stay happy

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What Austria needs to do to keep its luck coming

IT WAS an Austrian economist, Joseph Schumpeter, who in his 1942 book “Capitalism, Socialism and Democracy” introduced the concept of “creative destruction”: that old ways of doing things are constantly being swept away to make way for new ones. Austria saw a great deal of destruction in the first half of the 20th century and had to reinvent itself after the second world war. In the six decades since then it has succeeded beyond expectation, thanks in large measure to its own efforts but also helped by favourable external factors: a prolonged period of peace in Europe (except in the Balkans), an ever-expanding European Union, the collapse of communism and growing prosperity in the world.

Austria's economy underwent a measure of creative destruction in the 1980s when many of the country's nationalised industries were privatised and restructured. As this special report has argued, the overall effect was positive, and the increased emphasis on markets and competition since then has done the economy nothing but good.

Topfoto

In with the new, said Schumpeter

The opening up of new markets in central and eastern Europe from the 1990s brought a further bout of change that has proved almost wholly beneficial for Austria. Its businesses, many of them small and nimble, were quick to seize these new opportunities and profited handsomely, as did the economy as a whole.

Austria's (relatively late) entry into the EU also brought some upheavals, but by and large the country has done well out of membership. Even so, ordinary Austrians, unlike the business elites, have little affection for the club and remain worried about letting in too many workers from the new member countries.

Meanwhile, Austrians' traditional inferiority complex vis-à-vis Germany next door, with ten times as many people, has melted away as their economy has outperformed their big neighbour's. They have noted with quiet satisfaction that recently tens of thousands of workers from eastern Germany have arrived to work in Austria's tourist industry: the traffic used to go the other way. (Less pleasingly, large numbers of German students have been flocking to Austrian universities to beat German admission quotas.)

So has Austria seen enough creative destruction for a while? Wilhelm Molterer, the finance minister (and head of the People's Party), gives a Schumpeterian answer: “New competitors come up all the time. What we need is permanent reform.” He approvingly points to the reforms launched by the previous government, which had a relatively free hand because the then ruling coalition was dominated by his party. The current grand coalition, explains Mr Molterer (who is a hot tip to become the next chancellor), makes reforms rather more difficult.

There are plenty of things Austria needs to do if it wants to keep up its economic performance. Last year the WIFO economic research institute, at the invitation of the two sides of industry, produced a white paper in which it argued that continued high growth and full employment will depend on Austria advancing from the status of an upper-medium-tech country to an ultra-high-tech one. Over the past 15 years the country has already moved from a below-average position within the EU in its use of technology and innovation to nearer the top. Its spending on research and development (R&D) as a proportion of GDP has risen from 1.4% in 1993 to 2.4% last year. That is good, but not yet good enough. Karl Aiginger, WIFO's boss, argues that the only things Austria should be producing are those that sell on quality rather than price and require a measure of innovation and special skills to make. Anything else is a waste of time.

Nobody's perfect

But what does the country need to do to get to that happy position? Ask any Austrian academic, industrialist or politician, and he or she will come up with a shopping list that includes some of the following items:

• **Infrastructure**. Eighteen years after the fall of the iron curtain, the construction of road and rail networks is still lagging behind the expansion of business in central and eastern Europe. A motorway to Bratislava, Slovakia's capital, only 65km from Vienna, is still not quite ready. Austria's transport master plan also provides for improvements in the country's links to the south which will involve massive new tunnels through the Alps, but none of this will happen soon.

• **Public spending**. Austria's overall tax burden, at 43% of GDP, is three percentage points higher than the EU-15 average and seven percentage points higher than the OECD average. Corporation tax was cut to 25% a couple of years ago, but top personal-income tax rates are still widely seen as too high (though inheritance tax is about to be abolished). Another tax reform is planned for 2010, the year of the next election. Economic conservatives argue that currently buoyant tax revenues should be used to reduce the budget deficit rather than to cut taxes.

Everybody's favourite target for savings is excessive bureaucracy, which a federal structure makes particularly hard to tackle. The individual states depend on central government for almost all their revenue, so they have little incentive to cut out duplication and waste. The potential for savings is said to be large, but political sensitivities may prevent it from being realised.

• **Competition**. This is alive and well in export-oriented sectors, but services such as public utilities, transport, health services and some professions lag far behind. Austria's shop-opening hours are still among the most restrictive in Europe.

• **Labour market**. The labour-market participation rate among core full-time workers is high, but Austria has been less good at integrating groups such as women with young children and older workers, and far too many workers are able to retire early on grounds of disability.

• **Education**. This goes to the heart of what Austria has to do to remain competitive. Its spending on education as a share of GDP is above the European average, and the results used to be a source of pride. Its “dual” apprenticeship system, mixing formal learning and work experience, has been particularly successful. But the OECD's most recent PISA study on educational achievement shows Austria to be no more than middling in literacy and maths, and employers are complaining that would-be recruits cannot read and write properly.

Bridgeman Art Library

Don't let the music stop

Much of the debate currently revolves around secondary schools. The Social Democrats in the ruling coalition claim that selection for the different streams is taking place far too early and want to move it from age ten to 14. The most disadvantaged group is migrants' children, who often speak no German,

get no help with learning it and therefore miss out on a decent education. Unemployment among young migrants is much higher than the national average, storing up economic and social trouble.

University education is also under review. Reforms brought in a few years ago have moved the system towards the EU's Bologna model, with short courses that can lead on to further qualifications. Modest fees have been introduced to reduce the 40% drop-out rate, but political courage did not stretch to bringing in entry restrictions based on performance at school, which explains why German students are now piling in. Only 18% of Austria's working population have higher educational qualifications, well below the OECD average of 25%, and the number of young people taking science courses is particularly low. That does not augur well for a country aiming for high-tech status.

The government is trying to push up spending on R&D and encourage innovation, but critics say its efforts are hampered by responsibility for innovation policy being shared among four different ministries. To promote top-level science, the government is currently setting up a new “Institute of Science and Technology Austria”, modelled on American elite universities and offering only PhD programmes.

Ticking off all the items on the to-do list would take a lot more than one electoral term, particularly for a grand coalition. Some of them may not get done for a very long time. But at least the country is giving thought to what is needed if it wants to remain “felix Austria”; and attitudes are changing. Vienna's coffeehouses are as crowded as ever, and the cakes just as delicious, but perhaps people don't linger over them as long as they used to. Could those young Austrians on their ubiquitous mobile phones be ordering the collected works of Schumpeter?

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Sources and acknowledgments

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Offer to readers

Nov 22nd 2007
From The Economist print edition

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Business and the credit crunch

At the gates of hell

Nov 22nd 2007 | NEW YORK
From The Economist print edition

Illustration by David Simonds

Banks and brokers are having a terrible time. Now the misery is spreading

NAMING yourself after the three-headed dog that guards the gates to hell was, perhaps, asking for trouble. Cerberus, the private-equity beast in question, now finds itself at the centre of a fierce debate about whether corporate America is in for a hellish time, as the credit crisis spreads from financial services to the rest of the economy.

Only months ago Cerberus was praised as the saviour of the American car industry when it bought Chrysler from its German owner and struck a remarkable deal with the unions to cut jobs and benefits. But on November 20th it emerged that Cerberus's bankers had abandoned efforts to sell $4 billion of the debt it took on when it bought Chrysler. Investors turned up their noses even when offered a 3% discount.

Cerberus has also been hit by growing problems at GMAC, the financing arm of General Motors, in which it bought a 51% stake for $14 billion last year. GMAC reported a net loss of $1.6 billion for the third quarter, up from a loss of $173m in the same period last year.

More controversially, on November 14th Cerberus pulled out of a $4 billion deal to buy United Rentals, a power-tool rental firm. This provoked so much criticism that the famously secretive private-equity firm broke its vow of silence, telling the *Wall Street Journal* that the attacks on its credibility and integrity were “unfounded” and that it still has “more than $10 billion of available liquidity”.

What happens to private equity may be a leading indicator of how the crisis in the financial system will affect the rest of the business world, both because private-equity deals are so dependent on large amounts of debt, and because many of the shrewdest judges of corporate value work for private-equity funds. The number of new private-equity deals has plunged with the financial crisis, and nobody expects activity to pick up again soon. The collapse of deals suggests that the business climate has changed sharply.

But how, exactly? Were the cancelled deals so marginal, and so dependent on cheap credit, that a relatively small rise in the cost of debt ruined them? Did Cerberus conclude that prospects for the

American economy are now too bad to go ahead with the United Rentals deal? Does it see better uses for its capital elsewhere, in distressed debt, say? Is that $10 billion of liquidity really available? And is it really true that as goes Cerberus, so goes the rest of private equity, and the rest of business?

The only truly upbeat firms in America nowadays are the accounting giants, which for once are not being blamed for a financial disaster (this time that honour belongs to the rating agencies). They are determined to keep it that way, and are said to be racking up huge fees by challenging every assumption in banks' financial models to make sure they cannot be accused of optimism. The banks are thus having to disclose ever bigger write-offs, contributing to fear of recession in America both indirectly, by delivering a stream of bad news, and directly, by constraining banks' ability to lend (see article).

The reduced supply of credit is contributing to recessionary fears that are greater in America than in the rest of the world, because the American consumer faces an unusual combination of difficulties, says Ian Shepherdson of High Frequency Economics, a research firm. Fuel prices are soaring, house prices are falling, confidence is plunging and there are early signs that the jobs market is weakening, he says.

So far, the evidence that the credit crisis is spreading to other industries is more in the mind than in the data. For instance, most of GMAC's problems relate to its subprime mortgage lending, rather than defaults on car loans. But there are gloomy predictions about the outlook for consumer spending. Car sales are expected to be down from 16.5m last year to 16m this year, for example. The outlook for 2008 is even worse. Jerry York, a former GM board member, sees sales slipping to 15.5m, and Thomas Stallkamp, a former Chrysler president who oversees automotive investments at Ripplewood, another private-equity firm, expects something between 14.5m-15m. The lower figure would amount to the largest decline since 1991, when there was a full-blown recession.

There are other signs that stress is spreading, though it is not yet at recessionary levels—not least because corporate profits remain at record highs in America, and many firms have taken advantage of the years of plenty to get their balance sheets in shape. Even so, Home Depot recently said that it can no longer afford to continue with its share-repurchase plan. In the most recent survey of banks' senior loan-officers, 19.2% reported a tightening of lending standards to large and medium-sized firms, up from 7.5% three months earlier, and zero a year ago. Surveys of small companies suggest they are finding it harder to get the credit they need to grow.

Between June 12th and November 19th, the spread in interest rates between high-yield corporate debt and Treasury bonds doubled, from 2.6 percentage points to 5.2, says Ed Altman of New York University. The yield on high-yield bonds has risen to 9.33%, the highest level since 2002 and a sign of growing default risk, even though defaults remain near a historic low.

Mr Altman is especially worried by the large amount of low-quality debt issued in recent years, much of it to finance private-equity deals. Some 42% of high-yield corporate bonds issued since 2003 were rated B- or lower, rising to nearly 50% in the first six months of this year. Moreover, some $160 billion of leveraged loans are coming due next year. Refinancing them may be a struggle in today's financial markets.

Martin Fridson of FridsonVision, a research firm, has calculated that a severe recession (which, he stresses, he is not predicting) could result in a peak rate of between 16% and 20% of annual defaults on corporate bonds, far higher than in 1991. If so, lenders will retreat further and distressed-debt investors like Cerberus will be baying for blood. Businesses need lenders to finance their operations: they must be quaking at the prospect.

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Electronic books

Amazon's new toy

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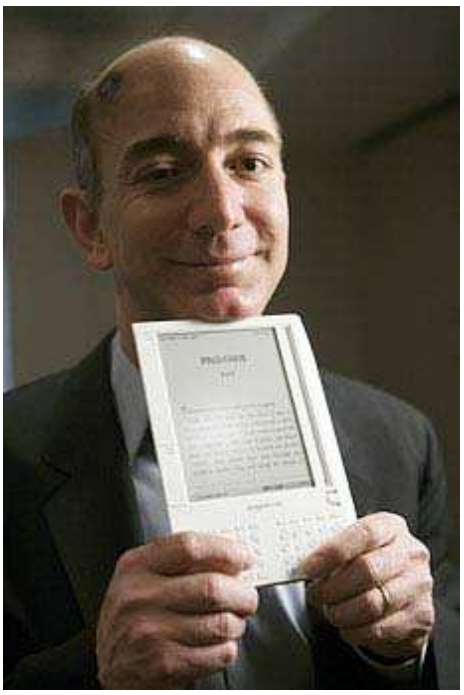
From The Economist print edition

It costs $399, has a silly name, and is an attempt to open up an entirely new product category. It is bound to fail. That is what people said about the iPod in 2001, at least, and that is what sceptics are saying about the Kindle, an electronic-book reader launched this week by Jeff Bezos of Amazon, an online-retailing giant. Will this new gizmo follow in the footsteps of Apple's music-player, and prove an unexpected hit? Like the iPod, it is not the first product of its kind but it adds a few new twists. Books can be bought for $10 from Amazon's online store via a built-in cellular connection, with no need for a PC. The wireless service is free, but users can pay to subscribe to newspaper and magazine articles and blog feeds. Critics say the design is clunky and the Kindle solves a problem that very few people have: the need to carry hundreds of books at once. And who wants an e-book for Christmas? But people were rude about the iPod when it first appeared, too.

AP



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Personal genetics

Within spitting distance?

Nov 22nd 2007 | NEW YORK
From The Economist print edition

The era of personalised medicine takes a step closer. But it is not quite here yet

MEDICINE has long been a mysterious art. Some people are more susceptible to disease than others, and the pills and potions that may help one person leave others uncured. But the past few days have seen steps forward in personalised medicine, in which diagnosis and treatments are tailored to each person's genetic make-up. Two rival firms have just unveiled services that will allow people to scrutinise their own genomes for $1,000.

The first was deCODE genetics, an Icelandic firm that has already developed genetic tests for several diseases. On November 16th it announced an internet-based service, called deCODEme. Customers supply genetic material in the form of a cheek swab, which is then compared against a database of hundreds of thousands of people's genomes, and a list of genetic variations that are linked to diseases. Customers can use the information, delivered via a password-protected site, to research their ancestry and assess their risk of developing various serious conditions.

Then, on November 19th, 23andMe, a start-up based in California's Silicon Valley, announced a similar service. The firm will analyse DNA derived from a saliva sample and post the results on its secure website, which will feature social-networking features (such as finding strangers with similar genetic variations) akin to those of Facebook. Navigenics, another Californian firm, says it will unveil a more medically oriented service, priced at around $2,500, in January.

Two keys have unlocked this market: a clever short-cut and a clever chip. All people are 99.9% identical, genetically speaking, and have almost all of the 3 billion letters in the human genetic sequence in common. In a large fraction of the population, only at certain places is one letter replaced by another. These points are called single nucleotide polymorphisms, or SNPs, and there are 10m or so of them. Looking only for SNPs is cheaper and quicker than analysing the entire genome.

The clever chip responsible for that analysis reduces an entire genetics lab to Lilliputian proportions. 23andMe, for example, outsources its genetic analysis to Illumina, whose BeadChip is a glass slide with millions of small beads on its surface. Attached to each of those beads are strands of DNA that are complementary to places in the genome where interesting SNPs are located. When an individual's DNA sample is sliced up and spread over the slide, the fragments are attracted to complementary bits of DNA and stick to them. Boffins can thus easily identify the SNPs of note in an individual's genome.

This is impressive stuff. If customers wish to explore their family roots in a semi-serious way, or see which relatives gave them green eyes, these new services will do the trick. Using them as reliable predictors of disease, however, is another matter entirely. One reason is that the SNPs may be inconclusive or misleading. 23andMe and deCODE insist that they are not medical-diagnostics services, but providers of genetic information. Both firms encourage customers to seek medical advice if needed, but that points to another potential snag. In America telling your doctor about such test results will probably result in a note being made in your medical file—which usually ends up being shared with the insurance company. Despite some legal safeguards, many Americans worry that insurers will use such information to deny coverage.

To ensure confidentiality, both deCODE and 23andMe say they will accept customers anonymously. But will they stoutly defend privacy if sued by insurers? We “cannot comment on a hypothetical situation” was the less than reassuring reply from one company this week. Another worry is that the firms plan to exploit the data themselves. People using 23andMe's service must agree to have their data anonymously aggregated for research.

Much good may come from these new services. But there is a prospect of false trails, wasted time and money or worse. For good or ill, however, the genomics genie is now out of the bottle.

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AMD v Intel

Oil money and hafnium

Nov 22nd 2007
From The Economist print edition

New twists in the long-running battle between the two biggest chipmakers

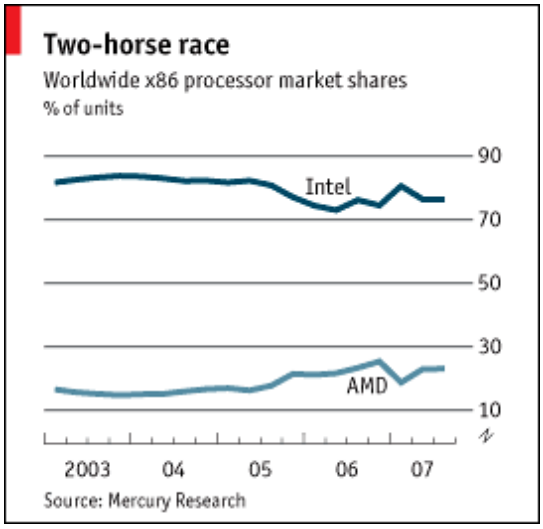
FASTER chips are the fuel of the computer industry. So the announcement on November 16th that Mubadala Development, an investment arm of oil-rich Abu Dhabi, would pay about $622m for 8.1% of Advanced Micro Devices (AMD), a leading maker of microprocessors, seems somehow fitting. The deal is an unexpected twist in the race between AMD and Intel, the world's largest chipmaker, in which Intel is again making the running.

For a while it seemed that AMD had pulled ahead of Intel in chip design. It devised a clever way to enable chips to handle data in both 32-bit and 64-bit chunks, which Intel reluctantly adopted in 2004. And in 2005 AMD launched a new processor that split the number-crunching between two “cores”, the brains of a chip, thus boosting performance and reducing energy-consumption. But Intel came back strongly with its own dual-core designs.

This month Intel began shipping its new family of “Penryn” processors, some of which have four cores. AMD offers similar chips under the “Barcelona” brand, and revealed its latest versions on November 19th. But Intel now has the technological edge. Next year it will launch new chips with eight cores on a single slice of silicon, at least a year ahead of AMD.

As the smaller of the two firms, AMD faces three handicaps. First, it has only two chip fabrication plants, or “fabs”, compared with Intel's 15, which still supply three-quarters of all processors for PCs (see chart). This makes AMD more vulnerable to manufacturing problems: its newest chips are not as fast as promised and have been hit by production delays. It also means that Intel can usually introduce new manufacturing processes faster. With Penryn, Intel has started using hafnium, an obscure metal, to insulate the transistors in its chips. This has made it possible to shrink the tiny switches even further without leaking too much current. AMD will not reach the same level of miniaturisation until mid-2008.

Second, Intel has more power over its customers, the PC-makers. AMD had hoped to catch up after convincing Dell, the world's second-largest PC-maker and a close ally of Intel's, to use its chips too. But the new relationship has been a disappointment so far. AMD claims that Intel is abusing its dominant position, and has complained to regulators in Asia, Europe and America. It alleges that PC-makers receive substantial rebates in return for buying most of their chips from Intel. America's Federal Trade Commission decided in October against opening a formal antitrust investigation, but in July the European Commission issued a “statement of objections” critical of Intel's business practices. In South Korea regulators are already considering penalties.



Third, there is money. Intel was able to recover quickly from its missteps because it has deep pockets. After slashing nearly 11,000 jobs in the past 12 months, its profit in the third quarter soared by 43%, to $1.86 billion. AMD, by contrast, has posted losses for four quarters in a row (although its latest loss of $396m was not as bad as expected) following its acquisition of ATI, a maker of specialised graphics chips, for $5.4 billion in 2006. Although the takeover made strategic sense, since AMD is now able to build high-end graphics features into its chips, it forced the firm to borrow heavily, just as it was fighting a bruising price war with Intel.

Hence the need for a cash infusion. The petrodollars from Abu Dhabi, if followed by the sale of some assets, could give AMD a fighting chance to survive this round with Intel and perhaps recover some of its former strength. This would be good news for customers, who benefit from the warring duopoly through

lower prices and more innovation. Mubadala Development will not get a seat on AMD's board. But the deal will prompt worries that if technology spending slows, as many industry-watchers expect it to, America's high-tech industry will suffer, and more resource-rich countries will take the chance to buy their way into it.

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The car industry

Not for the faint-hearted

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Why Tata Motors is favourite to buy Jaguar and Land Rover

Jaguar

For sale, one careful owner

THE sale by Ford of the two British premium marques, Jaguar and Land Rover (JLR), is fast approaching its conclusion. This week the three preferred bidders chosen by Ford, which has insisted that the two companies be sold together, have been presenting their plans to the British government and the unions. They are Tata Motors, India's biggest carmaker; Mahindra & Mahindra, an Indian maker of utility-vehicles, together with Apollo, a private-equity firm; and One Equity Partners, another private-equity firm. Some time in the next few weeks one of them will carry off two of the car industry's most evocative brands—and a heap of risk.

Ford wants a sale because its chief executive, Alan Mulally, wants to focus on turning round its North American business. He and other Ford managers are brutally frank in declaring that they are in a race against time that they may not win. A year ago, Ford mortgaged its assets in exchange for a $23.4 billion financing package to help it restructure. Mr Mulally has promised a return to profit in 2009.

Selling JLR may relieve Ford's management of an unwelcome distraction, but it will not provide a big boost to its coffers. The three bidders' offers are believed to be in the region of $1.5 billion. Ford could push the price up through an auction, but it is more concerned about doing a deal that is seen to be in the best interests of JLR and its 16,000 workers. This is not entirely altruistic. Britain is Ford's second-most-important market and it wants to be seen as a good corporate citizen. It also wants to stay on good terms with the unions.

The biggest union, Unite, wants to keep production, design and as much of the supply chain as possible in Britain. The most difficult issue will be the future of the Halewood factory in Liverpool, where the Land Rover Freelander and the Jaguar X-type are made. With a combined output of 261,000 units last year, JLR's need for three factories is questionable.

The bidder most likely to meet Ford's and the unions' requirements is Tata Motors. Although Unite's leader, Tony Woodley, has a soft spot for Jacques Nasser, the former Ford boss who is leading One Equity's bid, Ford is not convinced that it would give JLR the long-term stability it needs. There are also some concerns about the bid from Mahindra & Mahindra and Apollo. Initially, the Indian firm was interested in purchasing only Land Rover, for its four-wheel-drive technology.

Ratan Tata, the chairman of the Tata empire, sees the purchase of Jaguar and Land Rover differently. After other acquisitions, such as Tetley Tea and Corus, an Anglo-Dutch steel group bought for $13.2 billion earlier this year, Tata wants to increase its scope and scale in another industry. It longs for the kudos that would come from owning two such famous brands, and it has plenty of cash.

Some Ford executives believe that Tata would be buying Jaguar (after $10 billion of losses during 18 years of Ford ownership) and Land Rover just as they are coming good. Jaguar is about to start selling the new XF (pictured), its most exciting-looking saloon in a generation, and Land Rover sold a record number of vehicles in the past quarter and is solidly profitable.

But there is also risk aplenty. JLR depends on America for more than a quarter of its sales, so it is suffering from the dollar's weakness. Tata knows how to make cheap cars, but JLR operates in a totally different part of the market. And with tough new European emission laws due next month, JLR lacks the resources to bring fuel-saving technologies to its vehicles at the same speed as its German rivals, BMW and Mercedes, which are investing heavily in new super-efficient diesels and hybrid powertrains. Consequently, JLR faces the prospect of paying a fine on each vehicle it sells in Europe after 2012. Jaguar

and Land Rover are great brands going cheap. But it is not an investment for the faint-hearted.

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Foreign investment in Russia

Empowered

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From The Economist print edition

Oil and gas may be out of bounds, but the government is keen to attract investment in power generation

RUSSIA may not seem like the most alluring destination for big Western energy firms at the moment. After all, government inspectors have a nasty habit of harassing big foreign investors, which have found themselves squeezed out of several lucrative projects in the country's oil and gas industry in recent years. Meanwhile, the authorities have methodically built up Gazprom, the state-controlled gas giant, into a national champion. Yet in the field of power generation, European firms are lining up to invest billions.

Enel, Italy's former electricity monopoly, has purchased 37% of OGK-5, one of Russia's six wholesale power-generators, for 50 billion rubles ($1.9 billion). Last week it offered to buy the rest, which could cost it a further 98 billion rubles. E.ON, a big German utility, has bought 47% of another wholesaler, OGK-4, and plans to raise its stake to 70%. Fortum, a Finnish utility, owns a quarter of a regional generator, and is planning further investments. In fact, claims Anatoly Chubais, the head of UES, the former parent of all these generation companies, a host of foreign firms, such as Gaz de France and Korea Electric Power Corporation, want to get involved.

Russia's power industry is enticing, explains Marco Arcelli, the head of Enel's Eastern European business, because it is one of the world's fastest-growing. In some regions, including areas where OGK-5 has power plants, demand for electricity is increasing by 6% a year—more than twice the rate in Italy. As it is, Russia is the world's fourth-biggest power market. Profits are meagre at present, but should increase when prices are deregulated.

Until recently, almost the entire power industry was in the hands of state-owned UES. But the government, at Mr Chubais's urging, has separated generation from transmission and retailing, and divided UES's power plants among the six competing wholesalers and 14 regional generators. These OGKs and TGKs are all being sold to private investors to finance an overhaul of Russia's rickety grid, which will remain in state hands.

If all this sounds rather like a throw-back to the Yeltsin era, when the Russian government sold entire industries at knockdown prices, it is no coincidence. Mr Chubais served for a time in Mr Yeltsin's government, and was the architect of its privatisation scheme. He says the present government will see through the overhaul of the industry, despite its penchant for national champions and its distaste for foreign profiteers, because it fears power cuts and the popular ire they might spark.

Russia's grid and power plants are going cheap because they are clapped out. Last year UES managed to fulfil only a third of requests for new grid connections in Moscow, says Mr Chubais. In 2005 a huge blackout crippled the city, much to the government's embarrassment. UES reckons that investment of $128 billion is needed by 2010—a sum that the government, though flush with oil revenues, is reluctant to provide by itself. Hence the sudden enthusiasm for foreign investment.

Some observers worry that the government will lose enthusiasm for deregulation when prices begin to rise and voters start to gripe. It has put off the hardest part, the deregulation of domestic power-prices, until 2014. But Mr Arcelli points out that sales to industry are more lucrative, are already partly liberalised, and should be entirely deregulated by 2011.

Gazprom is another worry. It has already won control of two of the generation companies, and will be the biggest supplier of gas to virtually all of them. It could favour its subsidiaries by selling them gas on preferential terms. No wonder, then, that Enel has invested in several Russian gas fields. It is also offering to sell a stake in one of its Italian power stations to Gazprom. For its part, E.ON is Gazprom's partner in a controversial pipeline scheme. Whether such special ties to Gazprom will help remains to be seen.

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French business and the press

That's what friends are for

Nov 22nd 2007
From The Economist print edition

Politics, business and the French press are getting chummier still

WHEN Nicolas Sarkozy met Erik Izraelewicz and a handful of journalists recently to discuss economic policy and the strikes in France, the editor-in-chief of *Les Echos*, France's most popular business daily, did not expect to end up discussing his own newspaper with the French president. But Mr Sarkozy said he could not understand why the paper's journalists had gone on strike several times to try to block the recent takeover of their publication by his friend Bernard Arnault, France's richest man. Mr Sarkozy insisted that Mr Arnault would respect the paper's editorial independence and would invest in its future. He then conspicuously wondered aloud whether Nicolas Beytout, another of his close friends, was happy as editor-in-chief of *Le Figaro*, one of France's leading national papers.

Exactly what Mr Sarkozy was getting at became clear a few days later, on November 20th, when Moët Hennessy Louis Vuitton (LVMH), the world's biggest luxury-goods conglomerate, which is headed by Mr Arnault, announced the appointment of Mr Beytout as chairman of *Les Echos* and of LVMH's media division, which owns a radio station and a handful of magazines. (Mr Izraelewicz will keep his job.) On the same day the Figaro group appointed Etienne Mougeotte as the new editor of *Le Figaro*. “No doubt Sarkozy approved Mougeotte's appointment, too,” says a journalist at *Le Figaro*.

Though Mr Sarkozy promised a “rupture” with many of the bad habits of the past when he came to power earlier this year, what remains of the independence of the media from business and politics seems to be regressing under his reign. More than three-quarters of the print media are controlled by Dassault, a defence company; Lagardère, a media and defence group; Edouard de Rothschild, a scion of the banking dynasty; and now LVMH. Serge Dassault, the owner *of Le Figaro*, is a senator in Mr Sarkozy's UMP party. Arnaud Lagardère, boss of Lagardère, and Martin Bouygues, the boss of Bouygues, a construction and telecoms group, who controls TF1, the most popular television channel, are friends with Mr Sarkozy and were witnesses at his now-defunct marriage. And after his election victory, Mr Sarkozy spent a few days on the yacht of Vincent Bolloré, a financier who invests in a wide range of media businesses.

“More than ever, journalists must mobilise so that editorial independence from political and economic power is guaranteed,” said the main union of French journalists this week, voicing indignation at Mr Sarkozy's interference. Journalists at *Les Echos* fret that Mr Beytout will meddle in their coverage of the luxury industry and presidential politics. At *Le Figaro*, Mr Beytout fought constantly with Mr Dassault, as he tried to keep the senator and his eccentric views at bay. But in his new job he will be in the owner's camp.

LVMH says editorial independence will be protected by safeguards offered to *Les Echos* journalists in July, including the right to veto the appointment of a new editor. According to Nicolas Bazire, Mr Arnault's right-hand man and a member of LVMH's executive committee, his employer offered the strongest editorial protection of any paper in Europe.

Mr Arnault has bigger ambitions in the media still. He is selling *La Tribune*, a loss-making financial daily. But he has shown interest in *Le Figaro*, which Mr Dassault does not want to sell, TF1, which Mr Bouygues does want to sell, and the *Financial Times*, Britain's business daily, owned by Pearson, a media group that is also part-owner of *The Economist*. Pearson's intentions are not clear, but with the sale of *Les Echos* to LVMH earlier this month for €240m ($332m) it has already done one lucrative deal with Mr Arnault.

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Glassmaking in Italy

Death in Venice

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The last generation at one of the world's oldest family firms?

Barovier & Toso

Made the old-fashioned way

AFTER coaxing the molten glass at the tip of a long steel rod to the correct length and thickness, the master craftsman carries it to his workbench and curves the still-hot material into the desired shape. Another piece of Murano glass, part of a complex, brightly coloured, three-dimensional jigsaw forming a chandelier, is ready for the cooling tunnel. The methods used at Barovier & Toso are much as they were when Jacobello Barovier began making decorative glass at the end of the 13th century.

More than 700 years and 19 generations later, Jacopo Barovier heads the family-controlled firm of glassmakers that bears his name. The Toso family, whose ancestors began making decorative glass in the 17th century in Murano, a small cluster of islands across the lagoon from Venice, acquired one-third of the capital when the two firms merged in the 1930s. The result is one of the oldest family firms in the world.

Despite its traditional manufacturing techniques, the ancient firm is highly profitable, and more than three-quarters of its €12m ($18m) annual sales come from exports. Barovier & Toso's best-known chandeliers are probably those installed 15 years ago in the Hassan II mosque in Casablanca, some of them 40 feet tall. More typical of the firm's output are large modern decorative installations like those illuminating the Four Seasons Hotels in Miami and San Francisco.

Barovier & Toso might seem at risk from Chinese competition, particularly as it makes all its own glass parts and does not rely on outsourcing to low-wage countries. Judging the quality of a chandelier hanging from a ceiling is not easy and Barovier & Toso's designs are vulnerable to copying. “Our edge comes from making unique pieces and customising our products,” says Mr Barovier.

Although Barovier & Toso has so far warded off foreign competition, much of the glass sold in Venice's shops that purports to be local comes from Asia, rather than Murano. Indeed, Mr Barovier believes Murano's glassmaking cluster, already a shadow of what it was 70 years ago, will be dead within a decade.

And the future of his firm? Jacopo, who reluctantly became involved in the family firm more than 30 years ago, may be the last of the line. His two sisters and his son are not involved in the company. Is Barovier & Toso a target for private equity? “I am unsentimental. That is a possibility,” says Mr Barovier.

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Face value

The capitalist communist

Nov 22nd 2007
From The Economist print edition

AP

How a poetic Marxist has transformed business prospects in West Bengal

UNTIL a few years ago foreign capitalists were unlikely to look for investment opportunities in the Indian state of West Bengal, seat of the world's longest-serving democratically elected communist government. They were about as likely to ask for the novels of Gabriel Garcia Marquez in Bengali, the local language. That both are now readily available is largely down to one man. He is Buddhadeb Bhattacharjee, the state's chief minister, a poet and playwright, the translator of the great Colombian-born novelist—and a life-long communist.

Since taking charge of West Bengal in 2000, Mr Bhattacharjee has embraced business with apostate zeal. The results have been little short of revolutionary. Under a coalition of leftists led by his own Communist Party of India (Marxist), which has won seven consecutive elections, West Bengal was previously best known for industrial action, capital flight and the immiseration of its capital, Calcutta, recently renamed Kolkata. Things improved slightly in the mid-1990s, after investors were officially invited to the state. But only in recent years, after Mr Bhattacharjee began travelling the world and wooing foreign companies, have many actually come. They have joined an influx of Indian firms in computer services, manufacturing and steelmaking. Tata Motors says that next year it will start producing a new low-cost car—expected to sell for less than $3,000—at a factory it is building at Singur, near Kolkata.

Mr Bhattacharjee, who has a reputation for probity unusual in an Indian politician, has been credited with this success. In person, he is modest and engaging. With shining eyes and a breathy chain-smoker's voice, he enthuses on topics from agri-business to consumerism and Indian poetry, which he often quotes. In private life his tastes are Gandhian in their austerity: he has lived with his librarian wife and environmentalist daughter in the same two-bedroom flat for two decades. Azim Premji, the chairman of Wipro, a big computer-services company, has called Mr Bhattacharjee India's best chief minister. The prime minister, Manmohan Singh, agrees.

But how on earth does Mr Bhattacharjee reconcile his capitalism-friendly actions with his Marxist colours? He claims to remain a communist to his tobacco-stained finger-tips. Yet he admits that it is getting hard to know what that means. “The world is changing, communists are changing, even in China,” he says. “We are learning from our mistakes.” The comparison with China is obvious. Some Indian commentators have likened Mr Bhattacharjee to China's great moderniser, Deng Xiaoping. He laughs off this suggestion, and notes that communist ideology is practically extinct in China. Yet his own “Marxist principles”, which he says he has discussed at length with Hugo Chávez, the president of Venezuela, do not sound terribly radical. They are, he says, to “protect the poorest of the poor, protect un-organised workers, protect womenfolk who have no income.”

Mr Bhattacharjee is not the first leader to preach socialism while practising capitalism. And he does have a better excuse than most. In India the central government calls the shots, and as West Bengal is but a span in India's great democratic wheel, he says, “we have to formulate our policies within this structure.” And given the reality of West Bengal's wrecked economy, there is much to be done. “For many years, there were problems. We made some mistakes,” he says. “Now we want investment.”

Alas, he may have wanted it too much. He is now suffering a disastrous fallout from a key policy of Mr Singh's—the creation of special economic zones (SEZs)—that has gone badly awry in West Bengal. SEZs are lightly taxed industrial havens, roughly based on a Chinese model, intended to promote investment in infrastructure. But in democratic India, unlike autocratic China, acquiring land for development is a greater bar to industrialisation than any tax—particularly in West Bengal, the country's most densely populated state. This is something that Mr Bhattacharjee, by his own admission, too blithely ignored.

Petrochemicals and pitchforks

His government promised 9,000 hectares (22,000 acres) of farmland in the district of Nandigram to the Salim Group of Indonesia, which wants to build petrochemical plants in two SEZs. But it did not bother to consult the peasants who were to be dispossessed. This sparked protests in January in which at least six people were killed. Mr Bhattacharjee has promised to shift the two SEZs. But Nandigram remains violent and lawless, fought over by Maoist and Marxist party thugs. This month a dozen people are reported to have been killed and several women raped. Yet Mr Bhattacharjee defended this outrage, claiming that the Maoists had been “paid back in their own coin”.

The dispossessed are not alone in their protests. India's urban classes retain a sentimental fondness for village life, poor and squalid as it may be. This is especially true in West Bengal, where peasants are officially considered the vanguard of a proletarian revolution. On November 14th a group of Bengali intellectuals led 60,000 people on a march through Kolkata to protest against both the recent violence and Mr Bhattacharjee's response to it. Many said that his pandering to business was to blame.

The chief minister is certainly to blame, in part, for the crisis. And with a general election expected next year, in which the Communists are expected to do badly, there is talk that party bosses, wedded to the outworn ideology that he has so sensibly forsaken, might force Mr Bhattacharjee to quit. That would be a pity. India needs more leaders like Mr Bhattacharjee, who is a talented administrator, even if his political views remain enigmatic. Quoting Vladimir Mayakovsky—a Russian poet whose verse he has also translated into Bengali—he says: “Proletarians arrive at communism from below, but I from poetry's sky plunge into communism, because without it, I feel no love.”

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The risk in nanotechnology

A little risky business

Nov 22nd 2007
From The Economist print edition

Illustration by Bill Butcher

The unusual properties of tiny particles contain huge promise. But nobody knows how safe they are. And too few people are trying to find out

Get article background

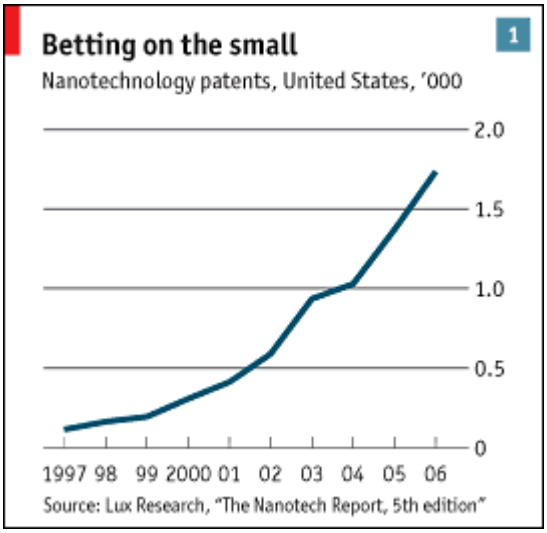
WAVING a packet of carbon nanotubes accusingly at the assembled American politicians during a hearing last month in Congress, Andrew Maynard was determined to make a point. The nanotechnology expert at the Woodrow Wilson International Centre for Scholars in Washington, DC, had bought the tiny tubes on the internet. They had arrived in the post along with a safety sheet describing them as graphite and thus requiring no special precautions beyond those needed for a nuisance dust.

Dr Maynard's theatrics were designed to draw attention to a growing concern about the safety of nanotechnology. The advice he had received was at best uncertain, and at worst breathtakingly negligent. For a start, describing carbon nanotubes as graphite was rather like describing a lump of coal as a diamond. Graphite is made of carbon, just like the nanotubes, although the tubes themselves are about 1m times smaller than the graphite that makes up the “lead” in a pencil. Carbon nanotubes may be perfectly safe, but then again, they may have asbestos-like properties. Nobody knows. Indeed, industry, regulators and governments know little about the general safety of all manner of materials that are made into fantastically small sizes.

This lack of knowledge is so great that research can paradoxically add to the problem. Vicki Colvin, a professor of chemistry at Rice University in Texas and one of the world's leading experts in nanotechnology-risk research, told the same hearing: “If you fund five teams to understand nanotube toxicity, and they get five different answers, your research investment hurts you, because it creates uncertainty. The bad news is that we have way over five different opinions about carbon-nanotube toxicity right now.”

In the past few years the number of consumer products claiming to use nanotechnology has dramatically grown—to almost 600 by one count. Patents are rapidly being filed (see chart 1). For a product to count as nanotechnology, it does not need to contain a tiny machine—though some seers imagine that as the field's ultimate aim. It is enough merely for some of the material to have been tinkered with at a small scale. Often that can involve grinding down a substance into particles that may be only a few nanometres big—a nanometre is a billionth

of a metre—about 100,000th of the thickness of a sheet of paper. These particles can also be engineered into shapes that provide some functional property, like rigidity. The variety of shapes includes rings, shells, wires, beads, cages and plates. The particles and shapes can also be incorporated into other materials to bestow useful properties on them.



Honey, I shrunk the silver

Some nanotechnology products are applied directly to the skin, as cosmetics and sunscreens. Titanium dioxide is commonly used as the white pigment in sunscreen. When it is ground into nanoparticles it can still block harmful ultraviolet radiation, but it allows visible light to pass straight though, which means modern sunscreens can appear completely transparent, while offering the same protection as the old white stuff.

Many products are now embedded with silver nanoparticles. At such small sizes, silver can have antimicrobial properties. Silver nanoparticles may come in handy wherever you want to kill germs—for instance, in things as diverse as children's dummies (comforters to Americans), teddy bears, washing machines, chopsticks and bed linen. Hence nanotechnology can be used in food production, most often as nanoparticles of silver in food-preparation equipment. The food industry is also trying to restructure ingredients at the nanoscale so as to include particles of trace metals in food supplements and to produce less-fattening foods.

All that sounds alarming, but assessing the risks calls for perspective. Humans are already surrounded by nanoparticles of one sort or another. Much of the food people eat is made of naturally occurring nanoscaled components. Each person breathes in at least 10m nanoparticles a minute. Most of them do no harm.

The trouble is that some—such as the particles from a diesel-engine exhaust—are known to cause serious health problems. Moreover, despite hundreds of years of experience in chemistry, it is not easy to predict how a substance will behave when it is made extremely small. That means, you cannot be sure how it will affect health.

Nanoparticulate versions of a material can act in novel ways—indeed, as with silver, that is what makes them so useful. When they are very, very small, materials, such as copper, that are soft can become hard. Materials, such as gold, that would not react to other substances become reactive. And when they have been shrunk, materials, such as carbon, that are perfectly safe might become unsafe. Plenty of research suggests that nanoparticles of harmless substances can become exceptionally dangerous.

One reason for this change is that a tiny thing has a large surface area relative to its mass. Atoms on the surface of a material are generally more reactive than those inside (which is why powders dissolve more quickly than solids do). Half of the atoms in a five-nanometre particle are on its surface, which can make it many times more toxic than expected by weight alone. Nanoparticles are small enough to be transported into the human body more easily and into the environment in new ways.

Research on animals suggests that nanoparticles can even evade some of the body's natural defence systems and accumulate in the brain, cells, blood and nerves. Studies show there is the potential for such materials to cause pulmonary inflammation; to move from the lungs to other organs; to have surprising biological toxicity; to move from within the skin to the lymphatic system; and possibly to move across cell membranes. Moreover, these effects vary when particles are engineered into different shapes. There is currently no way of knowing how each shape will behave, except by experiment.

Britain's Royal Society was concerned enough about all this to recommend in 2004 that nanoparticles be treated as entirely new substances. The European Commission concluded that each new material should be assessed on a “case by case basis”. However, understanding the environmental, health and safety (collectively known as EHS) risks is difficult.

Many governments take the view that, in terms of product-safety, nanotechnology changes nothing. The responsibility for managing EHS risk remains with companies themselves. Firms must make sure that the goods they produce are safe for consumers, that their workers are healthy and that their factories and

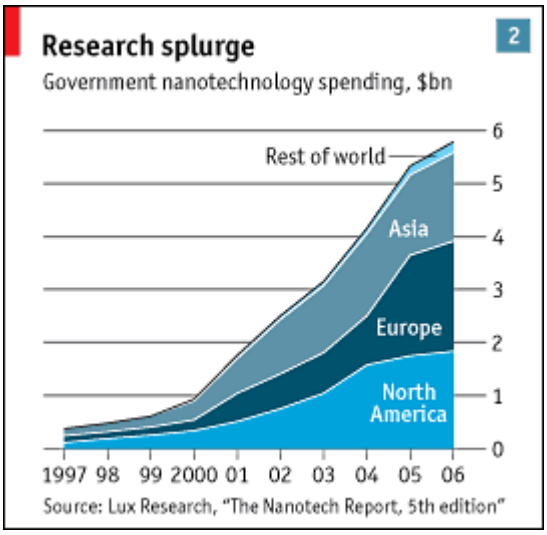
products do not cause damage to the environment. On the whole, that is the right approach in a market economy, but the uncertainties make it hopelessly over-optimistic for nanoparticulates.

In the absence of any firm guidance from governments as to exactly what tests are needed to ensure a product is safe, businesses are devising their own. Michael Holman, an analyst with Lux Research, an emerging-technology consultancy based in New York, says that larger companies can probably cope with the research because they are more familiar with the risks of liability and regulation. But the task is beyond some small companies. “We talk to them and they say they are just doing titanium dioxide and they are not concerned, because it is a safe material, and we think they're whistling to the graveyard on EHS risks,” he says.

The analysts at Lux reckon that the applications that are likely to cause most (real and perceived) concern are those intended to go into or onto the body: cosmetics, food additives, pharmaceutical-delivery systems, novel therapeutics and textile coatings and treatments. But Lux says there is also a lot of uncertainty over what happens to these substances at the end of their lives. Carbon nanotubes have been used for years in industry. They have been embedded in materials like plastics to increase their toughness and provide electrical conductivity for components that are electrostatically painted. But it remains unknown, for instance, if they can enter groundwater when the products that contain them are dumped or broken up.

Businesses have good reason to make safe products. But the temptation for a company, especially a small one, is to spend its precious research budget on new products rather than basic investigations into the safety of nanotechnology that would benefit everyone, including its competitors. The risks may end up being carried by insurers. However, Swiss Re, one of the biggest insurers and one that has taken an early interest in nanotechnology, reckons insurers are not yet fully able to assess the risks. At the moment, firms with product-liability insurance are implicitly insured for their nanoparticles.

One hope is that the insurers will demand more certainty. Another, given the fundamental principles that have still to be established, is that some of the money governments are pouring into nanotechnology (see chart 2) will be diverted into the basic safety research the technology needs to thrive.



Patchy, at best

Although scientists' favourite alarm call is that “more research is necessary”, the extent and the frequency of their cry suggests that in nanotechnology they may be right. The Nanotechnology Industries Association, a British trade body for companies operating in the field, wants better co-ordination in the way that money is spent on nanotechnology-risk research. According to Steffi Friedrichs, the association's director, “current research projects and their results are patchy to say the least.” Research tends to be in areas that interest scientists, rather than what would be most useful for industry as a whole let alone the protection of consumers. For several years there have been complaints about a lack of organisation and leadership.

Earlier this year the Council for Science and Technology, which advises the British government, warned that progress on risk research into the toxicology, health and environmental effects of nanomaterials was far slower than promised. It said there was a “pressing need” for a strategic programme of spending.

It is much the same story in America, where the co-ordination and planning of risk research is also taking years longer than anyone would have imagined. This has frustrated Brian Baird, the chairman of one of Congress's science committees. On October 31st he told the government's National Nanotechnology Initiative (NNI), that it was not acceptable that its EHS strategy, and its implementation plan, had not materialised some 18 months after it was due. Simple prudence, he said, suggests urgency in making sure that the work catches up with, or even surpasses, the pace of commercialisation.

America already spends the most on EHS research into nanotechnology. Depending on who does the counting, it ranges from $11m to $60m. But of the larger, government-claimed figure, nobody is able to say precisely what this money is buying. Whatever the actual figure, Dr Maynard, waver of the carbon

nanotubes in Congress, says that at least $100m per year is needed in the next few years to finance research into just some of the basic questions. Along with a number of other leading scientists, he published a paper in the journal *Nature* last year that outlined the sort of research programme needed to put the understanding of nanotechnology risk onto a sounder footing.

What are the most important things such a programme could produce? Dr Maynard says he would like to see ways of measuring exposure to nanoparticles in the air and water; a method of getting a rough idea of what the toxicity of a nanoparticle might be, ideally with some quick and basic tests that could inform scientists and businesses of the most promising (and safest) routes to pursue; and guidelines for how to work safely with nanoparticles, including clearing up spills and managing waste.

This does not sound like much to ask, but it is a long way from happening. In America some scientists worry about a conflict of interest at the NNI—because it must both promote nanotechnology and mitigate its risks. In fact inertia is more likely to spring from the NNI's need to get 23 government agencies to agree on a research agenda. Clayton Teague, the head of the NNI, has no authority to twist arms.

This increases uncertainty over the safety of nanotechnology and makes the question of whether more regulation is needed a tricky one. Today's legislation is based on an ability to measure and monitor materials, and calculate risk. In Europe legislators have concluded that, although nanomaterials are covered by existing rules, this will not amount to much unless you have a way to identify hazards and evaluate risks.

Terry Davies, a fellow at Resources for the Future, an economics think-tank based in Washington, DC, and a former assistant administrator for the Environmental Protection Agency, says that American legislation, such as that for clean air and water, is based entirely on standards and the ability to monitor them. “We don't have a clue what kind of standards there are for nanoparticles in air or water,” he says. Some sampling of airborne particles is done, but it is still not clear what should be monitored. And in water there is no ability to monitor the presence of nanomaterials. Even if these things could be measured, he adds, nobody knows how to control them.

Weighing the smallest

Managing the risks in nanotechnology is a massive undertaking that will take years to develop and it requires careful planning and co-ordination, says Dr Colvin. It will also depend on scientists from around the world working together. They could start by agreeing on a common form of terminology and some basic skills and tools, such as how to measure nanomaterials, characterise them and ensure their purity. At the moment it is virtually impossible to weigh a ten nanometre-sized particle with any accuracy. All this work is being co-ordinated via the International Standards Organisation in Geneva, and presumably one day it will happen.

Meanwhile, nanotechnology is becoming part of the global economy. It could help produce trillions of dollars of products by 2014, ranging from face creams to computer chips and car panels, according to Lux Research. The risks from these products will often be very low or non-existent. In the computer industry, for instance, making smaller and smaller features on the surface of a chip is not likely to involve much risk to computer users. Motorists probably have little to fear from carbon nanotubes being embedded into a car door to make it more crash-resistant. Yet what happens to such products at the end of their life remains a question.

At the same time, nobody wants to stifle the innovation and potential benefits that nanotechnology promises. Ultra-small particles that are able to enter the brain might be used to deliver treatments for brain diseases. Nanomaterials also offer huge potential for making better batteries, generating green energy and producing clean water. It is little wonder that governments have been falling over themselves to put money into nanotechnology research. Slower to arrive has been the leadership and funding to do the necessary risk research, and to make sure that existing agencies can regulate a large, new, poorly understood area of risk. Mihail Roco, a senior adviser at America's National Science Foundation and one of the architects of the NNI, wrote earlier this year that nanotechnology research and development has advanced faster than the capacity of regulators to assess its social and environmental impact.

Scientists do not mean that nanoparticles are inherently unsafe, only that there is a yawning gap in understanding their effects. Yet safety legislation cannot be expected to work until the products of the technology are better understood. What does it mean to regulate nanotechnology materials when you cannot even measure their release into the environment or agree on how to weigh a nanoparticle?

In the longer term, researchers think that they will be able to devise a framework for understanding nanoparticles and predicting which will be hazardous before they are ever made. That would allow science, technology and business to focus on the materials that are most likely to be beneficial and profitable. It would be a huge prize, because it would enable the development of nanotechnology while guarding against a big health scare or environmental disaster. If, in the aftermath of an accident, the public discovered that scientists are unsure about a wide range of nanotechnology, it would wreck the development of potentially valuable and safe new products.

Had Dr Maynard's bag split wide open in Congress, scattering his carbon nanotubes into the air, would any harm have been caused? Probably not. But, as an answer, “probably” is not good enough.

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Currencies and oil

Countdown to lift-off

Nov 22nd 2007
From The Economist print edition

Illustration by Satoshi Kambayashi

Gulf countries are rethinking their currency pact with the dollar

Get article background

HARDLY a week goes by without a new reason to be gloomy about the dollar. The latest scare is that members of the oil-rich Gulf Co-operation Council (GCC) might loosen their links to the greenback, depriving the foreign-exchange markets of a reliable buyer of the troubled currency.

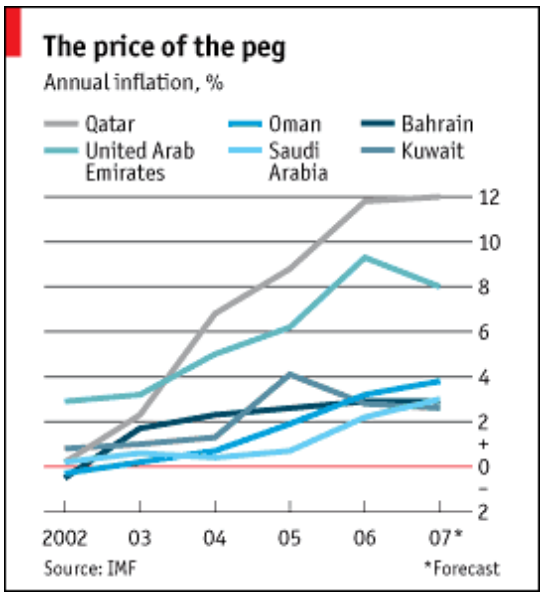
The United Arab Emirates (UAE), through its central bank governor, recently hinted that it would like to free itself from the dollar peg, but would prefer to do it in concert with the other GCC members—Saudi Arabia, Kuwait, Qatar, Oman and Bahrain. Last May Kuwait broke ranks and decided to track a basket of currencies. Since then, the Kuwaiti dinar has risen by nearly 5% against the dollar.

Now others might follow Kuwait's lead. Someone close to the GCC says that some members are advocating a substantial revaluation—perhaps by as much as 20-30%—if the dollar's slide continues. Another option being talked about would be to link the Gulf currencies to euros as well as dollars, with up to half the basket in the European currency. Further discussions will take place at a council summit on December 3rd and 4th. Futures markets are already pricing in a slight loosening of the dollar peg—though the UAE's central bank sought to quell speculation on November 22nd by cutting short-term interest rates.

The immediate problem for the Gulf states is that the inflationary effects of the oil-price boom are being amplified by their yoke to a weakening currency. Inflation, which until 2003 was rarely above 3% in the Gulf, is now around double-digit rates in Qatar and the UAE (see chart). Even in Saudi Arabia, where inflation has been more muted, it picked up to nearly 5% in September. Much of the pressure is from rising world food prices, which are a bulky item in consumer-price indices.

A revaluation would help cap inflation by making imported food cheaper. But housing costs are the biggest contributor to inflation in the UAE and Qatar, say Gerard Lyons and Marios Maratheftis, economists at Standard Chartered Bank. Spurred by strong oil revenues, these two economies have been growing at an annual rate of 8-10%, drawing in more workers from overseas and pushing up rents.

The rigidity of the exchange-rate regime gets in the way of policies that might temper these forces. Countries with pegs to the dollar have to mimic the policy of the Federal Reserve. If a GCC state tried to tighten its monetary policy when, as now, the Fed is easing, it would push its currency above the dollar peg.



The trouble is, a policy setting that is right for recession-threatened America is wrong for the GCC, especially at a time when oil prices are reaching record highs, as they briefly did on November 21st, of $99.29 a barrel. The pressures are made worse by speculative deposits, in anticipation of a revaluation, that drive down interest rates and add more fuel to the boom. The broad-money supply grew last year at an annual rate of 15-40% in GCC countries, according to Standard Chartered.

If, as seems likely, some GCC members let go of their existing dollar pegs, what might they put in their place? The simplest gambit would be a one-off revaluation: keep the link with the dollar but at a higher exchange rate. That would cap import prices and soak up the speculative hot money that has added to liquidity. It should also take the steam out of asset markets—and perhaps housing costs—by making investments more expensive for foreigners, including imported workers.

Yet a revaluation would not address the problem of policy inflexibility; the GCC would still be yoked to the Fed. A bolder course would be to follow Kuwait's lead and peg to a basket of currencies. Mr Lyons reckons that the dollar accounts for around 70% of the Kuwaiti basket, the rest made up of the euro and other currencies. Fuzziness about the precise make-up of the currency weighting allows Kuwait some discretion on interest rates—a “great benefit,” says Mr Lyons.

But even this is not ideal. Benchmarking to any rich-world interest rate is unlikely to suit the Gulf, since high crude prices depress income for oil importers but boost it for oil exporters. Brad Setser of the Council on Foreign Relations suggests one way around this problem is to have oil as one of the prices targeted in the basket.

A revaluation has costs. The huge stock of dollar assets held in the GCC would be worth less in terms of the home currencies. But unchecked inflation would also erode the domestic value of foreign assets and in a more damaging way.

A shift towards a looser peg in the GCC would undoubtedly hurt the greenback. At the very least, dollars would be purchased at a slower rate—leading to what Mr Lyons calls “passive diversification”. At worst, the policy might encourage others to follow, sparking panic sales of American assets. That is the main reason why Saudi Arabia is reluctant to move now, when dollar sentiment is so precarious. But given the inflation problem elsewhere in the GCC, the odds are that one or two more members will follow Kuwait.

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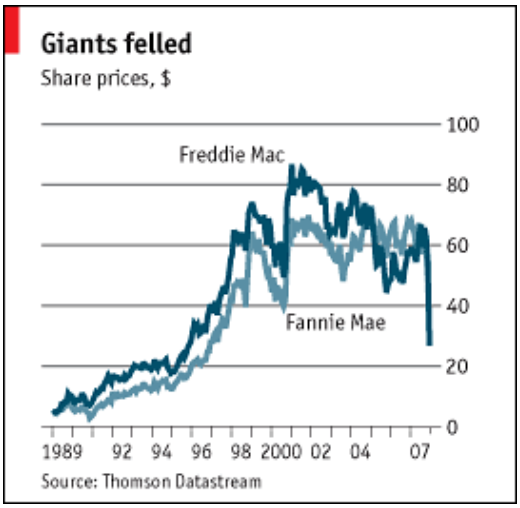
America's mortgage giants

Not-so-dynamic duo

Nov 22nd 2007 | NEW YORK
From The Economist print edition

The mortgage market's supposed saviours are its latest victims



WHEN it comes to nasty surprises, this is the credit crisis that keeps on giving. Until a few weeks ago it had been assumed that Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs) that tower over America's $11 trillion mortgage market, could survive the storm with at worst a few bruises.

That script is now being dramatically rewritten. Earlier this month Fannie posted a $1.4 billion quarterly loss. Markets were further spooked by an article on Fortune.com which suggested that the company might have changed the way it accounts for losses to prettify its numbers. An even bigger blow came on November 20th when Freddie joined its ugly sister in the red, to the tune of $2 billion, and said that it would seek (read: have) to raise new capital. Fannie has already tapped markets for more than $500m in fresh equity. Freddie's share price dropped by 29% on the day of its results, wiping out many years of gains (see chart). “This is not a happy time,” said Richard Syron, its boss.

Just weeks ago, politicians were calling for the lifting of regulatory caps on the GSEs' portfolios, imposed in 2005 after they mis-stated profits, so that they could take up the slack as private mortgage lenders retreated. But their capital crunch—Freddie is a mere $600m above the required minimum—leaves them ill-placed to be liquidity providers of last resort.

Unlike many banks, Fannie and Freddie are not waist-deep in the most radioactive structured products. But they took on more risk in recent years, including substantial amounts of paper linked to adjustable-rate mortgages (ARMs) for low-income borrowers. ARMs and securities tied to them accounted for almost a fifth of Freddie's new business in 2006, up from negligible amounts five years earlier.

Actual credit losses are only part of the problem. Freddie set aside $1.2 billion for such hits in the quarter. Its accountants forced it to mark down other assets by three times that amount to reflect sagging market prices, even though most of them will be held to maturity. Anthony Piszel, chief financial officer, says that its numbers are distorted by lots of “uneconomic noise”, such as the requirement to mark its derivatives book to market each day, while being unable to record offsetting gains in its loan portfolio until much later.

Things would also look less bad if Fannie and Freddie did not have to keep their capital-to-assets ratio 30% above normal requirements. They have been lobbying hard for the removal of this “surcharge”, which was also introduced after their accounting scandals. But their regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), wants to see more improvement on risk management and internal controls first. “This kind of market increases operational risk,” says OFHEO's James Lockhart.

Another concern is that the GSEs' woes may fan out, hurting the banks that rely on them to buy or guarantee their mortgages. It was no coincidence that Countrywide, the biggest mortgage lender, was forced to deny rumours of imminent bankruptcy on the day Freddie broke its bad news. There are thousands of smaller banks, too, that would be hit if the housing giants' losses continued to eat into their capital.

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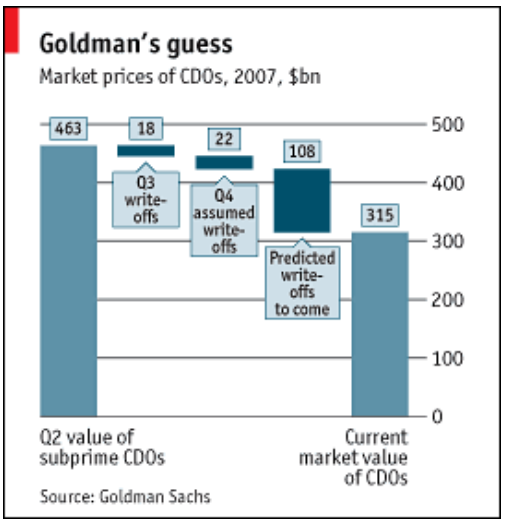
Bank capital

Tightening the safety belt

Nov 22nd 2007
From The Economist print edition

Banks' capital needs could end up tying them in knots



THE only thing bankers can have felt grateful for this Thanksgiving was a rest. Confidence in subprime-related mortgage products continues to fall. Rating agencies are slashing collateralised-debt obligations (CDOs) faster than you can slaughter turkeys. Analysts at Goldman Sachs reckon that, despite the large write-downs already announced by financial institutions, another $108 billion-worth of losses on subprime CDOs have yet to surface (see chart). Adding to the gloom, a $2 trillion source of mortgage funding in Europe, known as the covered-bond market, was temporarily suspended on November 21st because of sliding prices.

All this turmoil is focusing attention on banks' capital ratios, the amount of money they set aside as a percentage of assets to cover unexpected losses. This cushion is being squashed in a number of ways. First, net losses eat directly into capital. Second, since capital ratios are typically calculated on the basis of how risky a bank's balance sheet is, the ratings downgrades add to the amount of rainy-day money banks need to set aside. Third, assets are growing as banks take on the financing of more off-balance-sheet vehicles, which again adds to the capital they need.

At some banks, capital ratios are dropping fast. UBS, a Swiss bank, has seen its tier-one ratio (which divides a bank's risk-weighted assets by its core capital) fall from 12.3% at the end of the second quarter to 10.6%. At Citigroup the tier-one capital dropped to 7.3% in the third quarter, down from 7.9% in the previous one. It remains comfortably above the 6% threshold that American regulators use to define institutions as well capitalised. But as expectations of further write-downs grow, it and others with deteriorating capital ratios will be under pressure to reverse the trend.

There are a number of ways for banks to improve things. They can suspend share buybacks. Or sell non-core assets: Merrill Lynch's stake in Bloomberg, a financial-information provider, looks eminently disposable. They can cut dividends: expectations are growing that Citigroup will do so. In more extreme cases, they could issue new shares: the bond insurers, which depend on impeccable credit ratings and are important for the health of the banking system, may have no choice but to raise capital. One, French-owned CIFG, has been promised $1.5 billion.

Rights issues and punier dividends would be bad news for shareholders. But the really pernicious effect of capital weakness comes when banks rein in their lending and investment activity in order to keep their capital ratios constant. Back-of-the-envelope calculations from Goldman Sachs suggest that if banks suffer a $200 billion loss on subprime mortgages but want to keep their capital ratios at an average level of 10%, that would stifle lending by a whopping $2 trillion.

Regulators may tighten the screw as well. Confidence in the tier-one capital ratio favoured by European regulators seems to have evaporated, says Simon Samuels, an analyst at Citigroup. Investors seem to pay closer attention to more cautious capital measures such as the leverage ratio, which does not allow for any risk-weighted adjustment to assets.

Some regulators may be tempted to take a more conservative approach, perhaps by imposing additional charges on individual banks. They should be wary: banks may need to swerve to avoid a capital crisis; but slamming on the brakes entails dangers of its own.

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Buttonwood

Serial crunching

Nov 22nd 2007
From The Economist print edition

Credit problems refuse to go away

NO LONGER can the credit crunch be dismissed as a blip or an isolated phenomenon. Every other financial wobble since 2003 has lasted just a few weeks. This time, even two rate cuts by the Federal Reserve have failed to do the trick.

Indeed on some indicators, things now look even worse than they did in August. The desire for safety has driven the yield on ten-year Treasury bonds below 4% for the first time since 2005. The gap between the three-month dollar London Interbank-Offered Rate (which banks use to borrow from each other) and the federal funds rate has reached half a percentage point, higher than it was in the summer. According to Manoj Pradhan of Morgan Stanley, two-year swap spreads, another measure of risk aversion, are significantly higher than they were three months ago.

In part, this gap is based on a belief, bolstered by the minutes of the Fed's recent deliberations, that a weakening economy will force it to cut rates again in December. It also reflects concern that banks have yet more bad news to reveal.

But it is not just the banks. Investors are trying to guess where the credit crunch will have the greatest knock-on effect. George Cooper, a strategist at JPMorgan, says: “It seems quite clear that the credit problem is becoming systemic.” For a while investors thought the credit markets were ignoring the reality of strong economic growth; in fact, that growth was the result of previous credit excesses. Now the economy will have to deal with the consequences of tighter lending standards; the subprime effect is starting to be replicated in car loans and may soon crop up in credit cards.

What is a problem for banks today, Mr Cooper believes, will eventually become a problem for governments, as they are forced to mount rescues (as the Bank of England did with Northern Rock, a battered mortgage firm). Eventually investors will start to worry about the health of government finances.

Another knock-on effect may be felt in hedge funds, which have slipped out of the limelight in recent months. Back in July and August, with the collapse of two Bear Stearns hedge funds, the industry was perceived to be at the heart of the crisis. Industry data, however, suggest that hedge funds have long put the crunch behind them. The average loss in August was only around 2% or so, and funds more than made up for that in September. According to Hedge Fund Research, the average fund returned 3.2% in October, bringing the return for the year so far to 12.3%.

Of course, the hedge-fund industry invests in a wider range of assets than subprime mortgages; most funds are involved in the stockmarket, where conditions have been mostly positive this year (the average emerging-market hedge fund, for example, has returned 26.6%). But even those funds that specialise in fixed income have not been slaughtered; according to Hedge Fund Research, the average 2007 return, at the end of October, was 3.3%.

But do these figures represent the true scale of the problem? After all, every week seems to bring news of a write-down of assets at a leading financial firm: among the latest is Swiss Re, the reinsurance giant. Surely, some hedge funds have made similar mistakes.

It is hard to tell. The suspicion is that some credit-related funds have been valuing their assets on the basis of prices derived from models, rather than real markets. “The mathematical models people have been using to value credit derivatives have been very naive,” says Paul Wilmott, a financial consultant. The bad news may not be revealed until the positions have to be sold.

When might that be? One prominent investor is worried about the outlook for December, on the grounds that hedge funds will then have to meet the redemption demands put in by clients back in August and September (many hedge funds have three-month notice periods for those seeking to get back their

money).

The danger is that the crunch may be aggravated if hedge funds are forced to sell assets into an illiquid market at fire-sale prices. If funds then do have to mark down their portfolios further, that could trigger a further wave of redemptions. “There will be probably be funds that will not survive the recent market volatility. Those with mediocre records will be more harshly dealt with by investors,” says Gunner Burkhart of Lehman Brothers.

Do not overestimate the damage. Plenty of hedge funds are immune to the credit crunch and a few have profited handsomely out of it. On the other hand, do not assume they have all been clever enough to trade their way around it. Some may simply have been cleverer at hiding their losses.

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China's currency black market

The dambusters

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From The Economist print edition

A woman's arrest sheds light on how the Chinese evade currency controls

SINCE a police raid on her firm was broadcast on Chinese state television, To Ling has emerged as one of China's more intriguing financiers. The 43-year-old Hong Kong resident operated a black-market foreign-exchange business with an outlet in Hong Kong, four branches on the mainland, and a client list that included China National Petroleum and Sinopec, two state-run monoliths. Her firm handled transactions worth more than $1m a day. Now she has landed in jail.

The crackdown on her operations in mid-November has exposed how hard it has become for the Chinese authorities to keep a tight rein on capital flows. Chinese citizens, with well honed trading instincts, have spotted a glaring arbitrage opportunity: subsidised petrol on one side of the border that Hong Kong residents want to get their hands upon, and cheap shares in Hong Kong, compared with their mainland counterparts, that Chinese investors want to buy. Officially, both are off limits to the other. That is where Ms To stepped in, providing the currencies both communities needed to do deals.

The publicity given to the raid was clearly meant to be a deterrent. As part of the November crackdown under instructions from the Shenzhen branch of China's central bank, limits were placed on cash withdrawals to stop illicit funds from being carried over the border. Wen Jiabao, the prime minister, acknowledged on November 19th that vast amounts of currency were flowing out of China through illegal channels, about half from Shenzhen. This, he said, threatened the stability of both China and Hong Kong.

But what else can China expect? Its economy is increasingly integral to world trade, and benefits enormously from it. Yet it has foreign-exchange controls befitting an insular country, and pressures are mounting to get around them. Hesitantly, the government has sought to establish mechanisms, such as limited rights for Chinese fund managers to invest abroad, that would allow funds to seep out of the country. But they have not come to much. In August the idea was floated to allow people in Tianjin, a Chinese municipality, to invest in Hong Kong shares, the so-called “through train.” Hong Kong share prices immediately soared. But the proposal has since stalled because of the complicated logistics involved. Hong Kong share prices have retreated as a result, and had a particularly bad time after the announcement that cash withdrawals from Shenzhen would be capped.

There are other ingenious ways of side-stepping the authorities. One is transfer pricing, involving the export of products from China at a particularly low price to a friendly and lightly taxed country (such as Singapore or Hong Kong), and then re-exporting them at a higher price to a third destination. Another is via the gambling dens of Macau. Meanwhile, the gradual climb in the value of the yuan against the Hong Kong (and American) dollar has made it a more credible currency, and it is now accepted in parts of Hong Kong. Eventually, that will make firms such as Ms To's redundant. But publicity stunts such as her arrest are like trying to catch the wind with a butterfly net.

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The shipping boom

Crossing continents

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New global trade patterns are raising freight costs

BREAKING records can become monotonous after a while. The Baltic Dry Index, which tracks the costs of shipping “dry” goods such as iron ore, coal and grain around the world, dipped this week after hitting an all-time high on November 13th. But it is still up 154% from a year earlier.

As with so much to do with commodities, the extraordinary rise in freight rates is partly because of China's appetite for raw materials. A dearth of new ships, and flotillas waiting to berth in overcrowded ports (especially in Australia), are also driving rates higher. The cost of shipping iron ore from Brazil to China is now more than the cost of digging up the ore itself.

Yet what makes the problem worse (or better, if you are a ship-owner) are the ways in which shifts in supply and demand are altering trade patterns around the world, especially in commodities like iron ore and coal, which are the most frequently traded cargoes in international shipping.

Take iron ore. China's biggest suppliers—Australia and India—have been unable to cope with the surge in demand. According to Icap Hyde, a firm of shipbrokers, Australia's market share of China's iron-ore imports fell from 70% around 15 years ago to about 40% last year. Earlier this year, to ensure enough iron ore for its own industries, India imposed tariffs on sales of iron ore abroad.

Over the years, Chinese steel producers have scouted elsewhere for the metal—mainly in Brazil, where they have secured long-term supply contracts. But it takes three times as long to move cargo from Brazil to China as it does from Australia, which, in effect, reduces shipping capacity for each shipment of Brazilian iron ore to China that comes at Australia's expense.

Meanwhile, China used to export much more coal than it imported, according to Jon Chappell of JPMorgan. As recently as 2001, its net exports of coal were 89m tons. So far this year, it has imported almost as much as it has exported. Other East Asian countries such as Japan, South Korea and Taiwan relied heavily on China for coal and now have to import it from Australia, South Africa and the Americas. So does India. Meanwhile, drought in Australia has meant that large Asian importers have had to ship grain from as far away as America.

In general, points out Icap Hyde, there is an “oceanic imbalance” between the Atlantic and Pacific. Supply is spread across both oceans, even as demand is concentrated in Asia. Shipping ton-miles for the major “dry” goods, which indicates the extent to which more freight is moved over longer distances, rose by 45% between 2001 and 2006. That is good news for freight rates, if any more were needed. By all accounts, the bull run is likely to last until 2009, when a huge number of new ships are due to be launched. Let's hope they are built for trans-oceanic travel.

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Economics focus

A new fashion in modelling

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Illustartion by Jac

What to do when you don't know everything

“THE forecaster is like an entrepreneur,” says Roman Frydman. “He uses quantitative methods, but he also studies history, and relies on intuition and judgment. He is not a scientist.” According to the New York University economist, this fact has been lost on contemporary economists, who continue to pursue the perfect economic forecast despite abundant evidence that it does not, and cannot, exist. They dismiss their repeated failures in much the same way that self-styled reformers in Mr Frydman's native Poland once insisted that socialism was great, but just needed to be carried out better.

In the economics profession the leading inheritors of this communistic mindset, says Mr Frydman, are the proponents of rational-expectations theory, which assumes that the economy and the individuals within it act with perfect foresight. Yet he is equally critical of the more fashionable school of behavioural economics, or at least those of its practitioners who claim that although people are irrational, their irrationality can be modelled so precisely that the future can be forecast with great precision.

In a new book, “Imperfect Knowledge Economics”, written with Michael Goldberg of the University of New Hampshire, Mr Frydman sets out an alternative approach to prediction, in which the forecaster recognises that his model will inevitably be less than perfect. Their work has received glowing praise from Nobel-prize-winning economists such as Kenneth Arrow and Edmund Phelps, who wrote the introduction to the book—though it is unlikely to have gone down so well with Robert Lucas, who won the Nobel for his work on rational expectations.

There is nothing new in economics about the idea that people must make decisions based on imperfect knowledge. Frank Knight gave his name to “Knightian uncertainty” thanks to his 1921 book, “Risk, Uncertainty and Profit”, which noted that most business decisions involve a step into an unknown that is to some degree unmeasurable. And John Maynard Keynes observed that “human decisions affecting the future, whether personal or political or economic, cannot depend on strict mathematical expectation, since the basis for making such calculations does not exist.”

While reflecting these insights, imperfect-knowledge economics still sees a role for economic theory in forecasting. Messrs Frydman and Goldberg argue that, to be useful, economic forecasting models should be based on qualitative regularities in the way that market participants respond to new information—that is, patterns of behaviour that are observable and somewhat predictable. Though not perfect, these will often give a better clue to the future than no model at all, or models based on rational expectations or

behavioural economics.

Take bulls and bears, for example. Their analysis of the fundamentals leads them to opposite conclusions about where prices are going. But there is evidence that the way they revise their forecasts in the light of price movements may share common features, such as a tendency to become more risk averse the further the price of an asset moves away from what is generally believed to be its long-term fundamental value. This may work eventually to return the asset price to its fundamental value, though it may also cause it to deviate significantly from this value for long periods of time. This approach will not generate the “sharp predictions” beloved of most contemporary economists—which are doomed by imperfect knowledge to be wrong. But it will provide a broad sense of the state of play, which an enterprising forecaster can usefully combine with experience, intuition and so forth when making a decision.

To show how this works, Messrs Frydman and Goldberg examine the persistent failure of economists to predict movements in the currency markets. According to Kenneth Rogoff, an economist at Harvard who has long attempted to find rational models for predicting currency fluctuations, “it is stunning how hard it is to explain movements in exchange rates.” All the models based on rational expectations now say that, on fundamentals, the euro is overvalued against the dollar, he reckons. But does that mean the dollar will soon rise? Mr Rogoff says he has no idea.

In rational-expectations theory, a range of variables including inflation, interest rates and growth should have a predictable impact on currency movements, but in practice this theory has proved less useful for forecasting than tossing a coin. Among rational economists, the debate is over “whether the glass is 5% full or 95% empty,” he says. Only over longer periods—say two to four years—is there any evidence of exchange-rate predictability, which is far too long to be useful to traders or policymakers.

By contrast, the model developed by Messrs Frydman and Goldman, which assumes imperfect knowledge and learning, does significantly better than tossing a coin, although it is by no means right all the time. Mr Rogoff describes this work as innovative. Now, however, it must demonstrate that it can consistently maintain explanatory power in the future and over a range of markets, he believes.

Maths lesson

Messrs Frydman and Goldberg are now turning their attention to the troubled subprime-mortgage markets, and the performance of the rating agencies. The rating agencies, argues Mr Frydman, have generally been better at rating corporate bonds than rating asset-backed collateralised-debt obligations. Why? One reason is that the rating agencies used both a mathematical model and the judgment of their in-house specialists when forecasting the default probabilities of corporate bonds; on subprime-related securities, they could only use mathematical models, not least because the instruments were so new. “They had no experience, no intuition, no entrepreneur,” he says. That is “empirical proof that relying on models alone is not wise.”

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Human embryonic stem cells

Me too, too

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From The Economist print edition

Illustration by Stephen Jeffrey

How to make human embryonic stem cells without destroying human embryos

Get article background

SCIENCE moves fast. On November 14th *Nature*, one of the world's leading scientific journals, published a paper about the creation of embryonic stem cells using a technique called somatic-cell nuclear transfer (basically, taking the nucleus from a body cell and putting it in an unfertilised egg). This made the news because the researchers had performed their trick in monkeys. The result was thus the first primate embryos to have been cloned, as earlier reports of human cloning turned out to have been fraudulent.

There is, however, a second way of making an embryonic stem cell that has the genes of an existing individual. This is to take a body cell and order it to turn into a stem cell using a set of molecular instructions. A group of researchers at Kyoto University, led by Shinya Yamanaka, did this with mice last year. A commentary published alongside the *Nature* paper, by Ian Wilmut, the man who produced the first cloned sheep (using somatic-cell nuclear transfer to do so), referred to Dr Yamanaka's technique but said, “There is so far no sign that this approach could be effective in human cells.”

Well, there is now. Two papers published this week, one in *Cell* by Dr Yamanaka and one in *Science* by Junying Yu of the University of Wisconsin-Madison, have shown how to do the trick in human cells. Dr Wilmut is so impressed with their data that he has said he is now going to concentrate his efforts on this alternative technique.

People are interested in embryonic stem cells because they have the potential to grow into any other type of body cell. That raises the possibility of replacing worn-out tissues and organs with new ones that have the same genes as the patient and would thus be in no danger of being rejected by his immune system. This idea, known as regenerative medicine, is still some way off, but in the more immediate future the ability to grow pure samples of particular body tissues would be of enormous value in developing drugs. Genetically bespoke stem cells thus have the potential to be big business.

Non-destructive testing

The problem is that making them using somatic-cell nuclear transfer involves breaking up viable embryos, since the cells in question are found inside early-stage embryos, called blastocysts. That offends some people's moral sensibilities. Indeed, the same objection also applies to stem cells that are extracted from embryos produced without nuclear transfer. (Usually these are surplus to requirements for *in vitro*

fertilisation.) Both problems would go away if cells that behave like embryonic stem cells could be made without destroying embryos. And that is where Dr Yamanaka and Dr Yu may be able to help out. For, instead of starting with human embryos, they started with human body cells. Dr Yamanaka used skin cells from the face, whereas Dr Yu plumped for ones from the foreskin.

The trick is to persuade such cells to forget what they have become and remember what they (or, rather, their ancestors) once were in the embryo. In other words, specialised cells are ordered to change back into stem cells. This can be done by tinkering with their genes.

What makes a cell “this” rather than “that” is the way its genes are expressed. Though most cells in any individual have the same set of genes, not all of these genes are active in any given cell. The activity of genes is controlled by proteins called transcription factors that are, themselves, the products of genes. What Dr Yamanaka discovered in his work on mice was a group of transcription factors that switched on the pattern of gene expression which says, “I am an embryonic stem cell.”

Surprisingly, there were only four of them, known as Oct3/4, Sox2, c-Myc and Klf4. At least, that was the case for mice, as he found by tinkering with various combinations of transcription factors until he discovered a set that would do the trick. And mice and men being pretty similar at the genetic level, it is not too surprising that the same set works in people.

Indeed, it seems to work well. Dr Yamanaka's team has, for instance, been able to persuade its stem cells to turn into nerve cells and heart cells. That is encouraging for regenerative-medicine enthusiasts. The new cells also produced all the molecules known to be characteristic of stem cells and, when grown in bulk, organised themselves into three-layered structures characteristic of embryos. (Each layer is responsible for different sorts of tissue and organ.)

To be fair, all this was also true of the cells described in the *Nature* paper, which was written by Shoukhrat Mitalipov, of the Oregon Stem Cell Centre in Beaverton, and his colleagues. But his cells came from macaques, not humans, and his technique involves destroying the embryo.

Dr Yamanaka, then, has shown what is possible, but Dr Yu may have trumped him. That is because one of Dr Yamanaka's transcription factors, c-Myc, sometimes has the unfortunate side-effect of causing cancer. By going back to basics, Dr Yu found a different combination (Oct4, Sox2, Nanog and Lin28) that does not suffer from this problem. Cells transmuted by this combination also have the characteristics of embryonic stem cells.

The main thing to be said against the methods used by Dr Yamanaka and Dr Yu is the way that they persuade their experimental cells to churn out the appropriate transcription factors. They do it by infecting them with retroviruses that have had the four relevant genes spliced into their genomes. Retroviruses work by adding their genes into the chromosomes of their hosts, which then merrily churn out bits of new viruses. As Dr Wilmut points out, that would make transplanting tissues created this way into people too risky to contemplate. But a modified approach that does not involve viruses is likely to be the ultimate way of making human stem cells. And no embryo need be destroyed.

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Palaeontology

Claws for thought

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The fossilised pincer of the largest arthropod ever found

FROM time to time, people cross paths with some of the planet's larger arthropods. From fat, hairy spiders in the bath, to the creepy-crawlies such as huge beetles, enormous ants and gargantuan crabs in hotter climes, the world's larger arthropods are enough to make grown men shudder.

Yet the largest specimens of today are tiddlers compared with what scientists have unearthed in Germany. Simon Braddy of the University of Bristol, in England, and his colleagues have found the fossilised claw of a giant sea scorpion. When scientists say something is a “giant”, they use the word rather more literally than most people would when describing something clinging to the bathroom wall. The claw found by Dr Braddy suggests that *Jaekelopterus rhenaniae* was 2.5 metres long, making it the largest arthropod ever found. It would have been bigger than a modern man. The discovery is published in the current issue of *Biology Letters*.

The creature is believed to be the extinct aquatic ancestor of scorpions and possibly of all arachnids. Like scorpions and spiders, it was a voracious predator and had pointed mouth parts with which it grasped food. Insects, millipedes and crustaceans are also arthropods but they, by contrast, have jaws with which they chew their grub.

J. rhenaniae lived during an early part of the Palaeozoic era, which spanned 540m-250m years ago. During this period something strange happened to the world's arthropods and they all evolved gigantic representatives. Two-metre-long millipedes, colossal cockroaches and dragonflies with wingspans of some 75 centimetres prowled through a world that would have bustled with the scuttling sounds of giant insects and their relations.

How were these huge creatures able to exist? For many years the explanation has been that land-based arthropods were big because, when they were alive, the Earth's atmosphere was richer in oxygen. The giant millipedes, cockroaches and dragonflies lived at a time when oxygen comprised 35% of the atmosphere rather than today's 21%. As most arthropods breathe passively, it was thought that their size was controlled by the amount of oxygen that could reach the inside of their bodies. More oxygen meant bigger insects.

However, *J. rhenaniae* suggests this cannot be the whole explanation. That is because it lived more than 100m years before the other giant arthropods, at a time when oxygen levels were slightly lower than they are today. (The levels of dissolved oxygen in the water in which it lived would have reflected what was found in the atmosphere.)

Dr Braddy reckons that size may have become advantageous to *J. rhenaniae* and that evolution encouraged the trait. Some animals grow bigger over successive generations as only the largest can avoid predators and capture prey, and thus survive for long enough to breed. As for why giant arthropods are not seen today, Dr Braddy believes that they have been out-competed by animals that wear their skeletons on the inside of their bodies and operate more efficiently as a result. Vertebrates everywhere will be relieved to know that it is safe to venture back into the bathroom.

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Theoretical physics

Geometry is all

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A shape could describe the cosmos and all it contains

ONE of the mysteries of the universe is why it should speak the language of mathematics. Numbers and the relationships between them are, after all, just abstract reasoning. Yet mathematics has shown itself to be particularly adept at describing both the contents of the universe and the forces that act on them. Now comes a paper which argues that one branch of the subject—geometry—could form the basis of all the laws of physics.

Physicists are an overbearing bunch. They have long sought a “theory of everything”. Such an opus would unite the fundamental forces—gravity, electromagnetism and the two forces that become apparent only at the atomic scale—with the matter on which they act, in a single, overarching framework. It would describe the universe as it existed at the moment of its creation in the Big Bang.

The nearest thing they have to this—the Standard Model of particle physics—is messy in places and partial, because it omits gravity. Three decades of effort have been expended on string theory, which includes gravity but at the expense of having the universe inelegantly sprout hidden dimensions. Other potential avenues, such as loop quantum gravity, are also proving untidy. That a theory of everything might emerge from geometry would be neat, but it is a long shot.

Nevertheless, that is what Garrett Lisi is proposing. The geometry he has been studying is that of a structure known to mathematicians as E_8, which was first recognised in 1887 by Sophus Lie, a Norwegian mathematician. E_8 is a monster. It has 248 dimensions and its structure took 120 years to solve. It was finally tamed earlier this year, when a group of mathematicians managed to construct a map that describes it completely.

Dr Lisi had been tinkering with some smaller geometries. Soon after reading about this map, however, he realised that the structure of E_8 could be used to describe fully the laws of physics. He placed a particle (including different versions of the same entities, and using particles that describe matter and those that describe forces) on most of the 248 points of E_8. Using computer simulations to manipulate the structure, he was able mathematically to generate interactions that correspond to what is seen in reality.

Using geometry to describe the world is not new. Murray Gell-Mann performed a similar trick 50 years ago in an attempt to make sense of the plethora of particles that was then emerging from experiments. He placed these on the points of a geometric structure known as SU(3), and found that, by manipulating the structure, he was able to reproduce the interactions of the real world. Dr Gell-Mann also identified points that had no known particles associated with them—and predicted the existence of particles that would fill those gaps. He was awarded the Nobel prize after they were detected. Interestingly, some 20 gaps remain in Dr Lisi's model. That suggests that 20 particles (or, at least, 20 different identities of particles) have yet to be discovered. If Dr Lisi can calculate the masses of these, he will have made predictions that can be tested experimentally.

The particles must be relatively massive, because they would otherwise have been discovered already. Detecting massive objects takes energy. (Einstein's famous equation, $E=mc^2$, outlines how energy is equivalent to mass times the square of the speed of light.) When it is completed, the Large Hadron Collider, a machine being built at CERN, the European particle physics laboratory near Geneva, will create particles with greater masses than have yet been seen. It is due to start its scientific work in the summer of 2008, so a test of Dr Lisi's theory could come soon.

Although some famous physicists are championing the idea, Dr Lisi, who spends his time surfing and snowboarding and is not employed by a university or research institute, has by no means won the acceptance of all physicists. His work, which has been posted on the internet, has not yet been accepted for publication in any journal, although he has presented his ideas at research institutes and the work on

which his paper is based was funded by a grant from a charitable foundation.

Certainly, there are glitches with Dr Lisi's analysis and some of the truly fundamental problems that plague more conventional work remain. Yet the theory has several appealing facets. It is elegant. It is expected to make testable predictions. Unlike some of the more complicated efforts to devise a theory of everything, this one should either succeed relatively rapidly or fail spectacularly. And that is more than can be said for three decades of work by other physicists.

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Marine biology

The long haul

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Another reason why infant dolphins need their mothers

AS ANY mum knows, carrying the kids can be exhausting. After breastfeeding, it is the most energetically expensive parental duty known to mammals. Yet despite its high cost, creatures ranging from ground dwellers to tree climbers and even flyers do it. Now it has been seen in swimmers.

The calves of dolphins swim alongside their mothers in an arrangement known as echelon formation. Such behaviour was thought to promote bonding between mother and child. But Shawn Noren of the University of California at Santa Cruz has found evidence that echelon swimming is also a form of infant carrying.

Dr Noren studied the behaviour of captive bottlenose dolphins in Hawaii swimming underwater, both alone and in mother-and-calf pairs. Sometimes they swam around their tanks casually, whereas at other times they were directed and rewarded by their trainers to swim at their fastest. She filmed them, so that she could analyse the frequency with which they beat their tails as they swam and measure the amplitude of these powerful tail strokes.

She found that the top speed for mothers swimming with their calves was 24% lower than their fastest speed when swimming alone. The distance travelled per tail stroke also fell, by 13%, when mothers were accompanied by their young. The calves meanwhile benefited by gliding in their mother's slipstream. Calves swimming in echelon showed a 28% increase in average swim speed and a 19% increase in distance per stroke. In addition, calves in echelon spent over a third of their time gliding while no gliding was observed in calves swimming on their own. The results, which will be reported in a forthcoming issue of *Functional Ecology*, suggest that echelon swimming is the underwater equivalent to carrying a child.

The discovery could also explain why there are not more wild dolphins. The population has fallen in recent times because fishing techniques intended to target tuna were also catching many dolphins. Tuna fishermen pursue pods of dolphins because schools of tuna fish congregate beneath them. When the fishermen approach the pod, the dolphins flee and a chase ensues with the tuna following underneath. This continues until the dolphins stop, exhausted, and the fishermen bag the tuna from under them. Although new techniques mean they capture only the fish, dolphin populations are not recovering at the expected rates. If Dr Noren is correct, it may be that the chase is causing mothers that are carrying calves to abandon the young to their fate.

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King Hussein of Jordan

From the desert he rose

Nov 22nd 2007
From The Economist print edition

AP

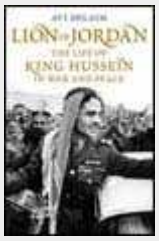
The Hashemite monarch was a brave, decent man. His efforts to end strife in the Middle East should be an inspiration for today's peacemakers

Get article background

WAS King Hussein of Jordan a great man who, by dint of his remarkable personality, courage and far-sighted perseverance, played a critical part in nudging the Israelis and the Palestinians at least halfway towards the settlement they may one day reach? Or was he as much lucky as brave (he was known a little patronisingly in the region as the “PLK”—“plucky little king”)? Was he a man who vacillated from crisis to crisis, buffeted by the ever-changing winds of global and regional politics but surviving against the odds by duplicitously playing off all sides against each other and taking bids from whoever seemed to have the highest cards at the time—Russians and Americans, Arabs and Jews, Baathists and monarchists—while seeking merely to stay on his rickety and often irrelevant throne?

Avi Shlaim, a Baghdad-born, Israeli-bred historian now at Oxford University, argues persuasively that the first, nobler version is the correct one. Particularly with regard to foreign policy, his weighty tome is the most authoritative biography of the king, who died in 1999 at the age of 63.

Lion of Jordan: The Life of King Hussein in War and Peace
By Avi Shlaim



Allen Lane; 698 pages; £30. To be published in America by Knopf in September 2008

Buy it at
Amazon.co.uk

No one doubts that Hussein was courageous, certainly in physical terms, often morally too. He was only 16 when his grandfather, King Abdullah, was shot at point blank range by a Palestinian nationalist a few yards from the young prince. After the brief reign of his unstable father, Talal, Hussein became king at 17 and ruled as an absolute monarch, with the odd trapping of democracy, until his death from cancer nearly 46 years later. He survived numerous plots to kill or oust him. At times he was vilified by just about every government in the region, and by quite a few farther afield. Several of his prime ministers were assassinated. The murder in 1958 of his cousin Faisal, king of Iraq, who was six months older than he was, seemed to presage the inevitable demise of the House of Hashem elsewhere.

Early on during his reign, the consensus was that Jordan, a British confection that had emerged like other nearby Arab states from the wreckage of the Ottoman empire after the first world war, was unlikely to

survive; in 1957, John Foster Dulles, America's then secretary of state, said it had “no justification as a state”, though he grudgingly added that that “did not mean that now is the time to eliminate it”.

In the course of Hussein's rule various Syrian, Iraqi, Saudi and Israeli regimes reckoned that Jordan could and should have been gobbled up, merged or at least partitioned. An Israeli intelligence report in 1980 described the king as “a man trapped on a bridge burning at both ends, with crocodiles in the river beneath him”.

Trying to solve the conundrum of Israel and Palestine was by far the biggest burden of his years on the throne. He realised much earlier than his fellow Arab rulers that, as Mr Shlaim puts it, “Israel was there to stay.” But Hussein took longer to accept that only a full-blooded Palestinian state on Jordan's West Bank, captured by Israel in the war of 1967, would satisfy the Palestinians, who were (and are) a majority of Jordan's inhabitants. For a long time he regarded the Palestine Liberation Organisation, which he ferociously suppressed in what amounted to a civil war when it tried to overthrow him in 1970, as a greater threat than Israel.

Mr Shlaim spells out in hitherto unpublished detail the history of secret dealings between the king and the Israelis, from 1963 until 1994, when he signed a peace treaty with the Jewish state. Hussein had at least 55 secret meetings (all listed) with leading Israelis, including at least seven prime and foreign ministers. Did these closet encounters advance the peace process, still stumbling along today without getting close to fruition? Mr Shlaim suggests that they did—and that the blame for their not getting further rests largely with the Israelis and their American backers.

The author has had unrivalled access to prime sources, especially Jordanian ones, including a candid interview with the king himself and with an array of his advisers and royal relations, as well as with a raft of senior Israeli intelligence people. The result is a pot of delectable nuggets. For instance, he reveals that a Jordanian debriefing of a son-in-law of Saddam Hussein, who defected to Jordan in the 1990s, showed that the Iraqi leader may well have been deterred from launching missiles with chemical warheads at Israel only because the Israelis told the Jordanians via a secret channel that there would be massive—by implication nuclear—retaliation by Israel.

Mr Shlaim concedes that the king was occasionally naive and impulsive, and could put too much store on personality and too little on ideology. On this score, his most grievous misjudgments were briefly to prefer the right-wing Israeli leader Binyamin Netanyahu, whom he seemed to back (perhaps even tipping the scales) against Shimon Peres, whom he did not trust, in the Israeli election of 1996; and the closeness of his friendship with Saddam Hussein, at any rate throughout the 1980s and in the run-up to the first Gulf war, when the king refused to join the coalition against the Iraqi leader. Mr Shlaim also argues that the Jordanian monarch should have avoided getting sucked into the war of 1967 against Israel.

Nor does he shrink from enumerating the king's other faults. Hussein could be ruthless—and probably had to be. When, in 1956, he dismissed John Bagot Glubb, who served the king after 26 years as commander of the Arab Legion, the British soldier was given less than a day to leave the country. Most cruel—but arguably astute—was the sacking of his brother, Prince Hassan, as crown prince, who had served him with complete loyalty for 34 years, just 12 days before the king died.

Hussein was a poor economic manager, letting corruption flourish far too widely at the top level; indeed, he himself used the treasury as something of a private source of patronage and sometimes of high living. The kingdom's survival depended invariably on its being bankrolled by outside powers—at first the British, then the Americans, sometimes (for too long) Iraq, occasionally the Saudis. And these subsidies—particularly the CIA's—were sometimes handed straight to the king.

On the whole, however, given the need for a rugged element of realpolitik and toughness in order to survive, he emerges from under Mr Shlaim's microscope as honest, fundamentally decent and, in a region noted for its brutality and treachery, notably merciful and kind. In his personal dealings, most strikingly with the Israelis, he was especially gracious. Above all, alongside his determination to sustain the House of Hashem, he was totally wedded to the cause of peace in the Middle East. That he did not fully achieve it, despite his peace treaty with Israel, was not his fault; indeed, without his relentless diplomacy (conducted often along those secret channels), the region might be even bloodier than it is already.

Lion of Jordan: The Life of King Hussein in War and Peace.
By Avi Shlaim.

Allen Lane; 698 pages; £30. To be published in America by Knopf in September 2008

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The Chinese in Africa

Still scrambling

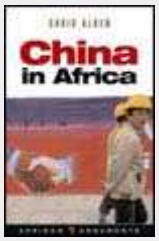
Nov 22nd 2007
From The Economist print edition

SINCE the late 1990s China has been hoovering up the world's oil and mineral deposits to sustain its rise to the top table of world manufacturing. The resource-hungry Asian country gets its raw materials from wherever it can, and asks few questions along the way. Nowhere has this been more true than in Africa; many noted the moment in 2006 when Angola surpassed Saudi Arabia as China's largest supplier of oil.

In this short and readable book, Chris Alden, a British academic who specialises in Asian-African relations, provides a clear overview of China's involvement with Africa, a relationship that is having a huge impact both on the country and the continent.

Some themes, such as China's acceptance of human-rights abuses by several African regimes that it supports, have been aired before. But Mr Alden has been lucky with his timing here; he has been able to record the beginnings of what could be a significant shift on this, and other issues, by China, particularly in regard to Sudan.

China in Africa: Partner, Competitor or Hegemon?
By Chris Alden



Zed Books; 154 pages; $23 and £12.99

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Amazon.co.uk

China has prided itself on a policy of non-interference in the countries that it does business with (unlike those nasty old Western imperialists). But in the last year it is clear that it has been forced to review this attitude; China has joined the Western chorus in pushing Sudan into accepting a big UN force in Darfur, whereas before it spent years shielding the government in Khartoum from Western pressure, especially at the Security Council.

As Mr Alden relates, by and large China has got used to an enthusiastic welcome from African countries that like its no-strings-attached investments. But it has been taken aback by the reaction against it in Zambia and South Africa, where local jobs have been devastated by an influx of Chinese imports. In Zambia there have also been protests about how China runs its mines.

All of this begs one of the great questions in international relations: how far will Chinese policy evolve as it gets further entwined in Africa? Will it participate more in UN peacekeeping operations? Will it give direct aid rather than soft loans? Will it start to take sides in African politics, as has happened in Zambia? Africa could be the anvil on which a new Chinese foreign policy begins to be forged.

Mr Alden is also good on some of the more obscure aspects of China's engagement with Africa. It is, for instance, not just big state-owned companies that are piling into Africa: small and medium-sized ones are there too. Much of the investment and trade is directed from the government in Beijing, as one would expect. But individual Chinese provinces have also been forging their own ties and doing their own deals with African countries or regions. Fujian and Zhejiang have been encouraging emigration to Africa as a source of remittances and of new jobs. Plainly, Chinese policy is in flux as it grapples with the political, social, religious and ethnic complexities of getting its raw materials out of Africa. It is a fascinating story, which will become more interesting and more important in the years to come.

China in Africa: Partner, Competitor or Hegemon?
By Chris Alden.
Zed Books; 154 pages; $23 and £12.99

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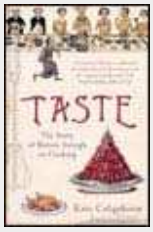
A history of British food

Feast and famine

Nov 22nd 2007
From The Economist print edition

“TELL me what you eat”, wrote Jean-Anthelme Brillat-Savarin, a French gastronome, in 1825, “and I will tell you who you are.” In his day, that was easy. If you were “up to the chin in beef, venison, geese, turkeys etc, and generally over the chin in claret, strong beer and punch”, like Horace Walpole at his country seat in Norfolk, to whom this passage refers, you were a member of the squirearchy who liked their food plain; the real toffs preferred something more elaborate. If, on the other hand, you were eating white bread, cheese, tea and sugar, you were one of the new urban poor whose diet had recently changed for the worse—from dark bread, pottage (a soupy stew made with vegetables, grains and the occasional bit of fatty meat) and ale (because the water was so dirty it might kill you).

Taste: The Story of Britain through its Food
By Kate Colquhoun



Bloomsbury; 416 pages; $34.95 and £20

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Amazon.co.uk

Food, at least for the better-off, has long been far more than a means of keeping body and soul together. It helps display power, wealth, taste and discrimination, impresses friends and foes, and often reflects the mood of the times. Whereas the court of Henry VIII dined in great splendour, the Cromwells didn't go in for entertaining, so no one else did either.

What people eat also depends on what they can get; think of potatoes, beans and tomatoes from the New World, which, once arrived, became indispensable. Those showy roast swans and peacocks of medieval times were all very well, but they were also very stringy, so when turkeys were introduced in the 16th century (at a great price), they soon graced all the best tables. Sugar was rare until the Spanish began to cultivate it in the Canaries and Antilles in the mid-1400s, and even then only the rich could afford it. Queen Elizabeth I loved sugary creations so much that by the time she was 65 all her teeth had turned black. Lesser folk did not get the opportunity to ruin theirs until sugar started to arrive in quantity from Barbados in the mid-17th century.

Religion played a part too. When Britain was Catholic, meat was off the menu not only every Friday but for the 40 days of Lent and other holy days as well. Fish was considered a poor substitute (probably for good reason, in the days before refrigeration). With the dissolution of the monasteries in the 1530s, monastic fishponds disappeared along with the monks, and fish became politically suspect. Fish consumption did not recover for centuries.

Even technology mattered—both in the sense of the kinds of foods that could be grown or brought in by ships, and later aeroplanes, and of the kind of equipment that was available to process and cook it. It was not until the early 19th century that open fires were beginning to be replaced by more easily controlled closed ranges. When tinned foods first became widely available in the second half of the 19th century, they were seen as a triumph of wholesomeness over the often adulterated, infested and rotten “fresh” food of the day.

The reciprocal relationship between food and history seems obvious now, but when Reay Tannahill published a book on the subject in 1973, she found she was first in the field. Since then it has been comprehensively covered, but this meticulously researched and handsomely produced book is a delightful addition to the list. Kate Colquhoun's enthusiasm for her subject leaps from every page.

Taste: The Story of Britain through its Food.
By Kate Colquhoun.
Bloomsbury; 416 pages; $34.95 and £20

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Poetry

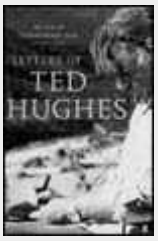
The private man

Nov 22nd 2007
From The Economist print edition

HE EMERGED, all of a sudden, in 1957: the most explosive new poetic talent of the English post-war era. Poetry specialised, at that moment, in the wry chronicling of the everyday. The poetry of Yorkshire-born Ted Hughes, first published in a book called “The Hawk in the Rain” when he was 27, was unlike anything written by his immediate predecessors.

Driven by an almost Jacobean rhetoric, it had a visionary fervour. Its most eye-catching characteristic was Hughes's ability to get beneath the skins of animals: foxes, otters, pigs. These animals were the real thing all right, but they were also armorial devices—symbols of the countryside and lifeblood of the earth in which they were rooted. It gave his work a raw, primal stink.

Letters of Ted Hughes
Edited by Christopher Reid



Faber and Faber; 756 pages; £30

Buy it at
Amazon.co.uk

It was not only England that thought so either. Hughes's book was also published in America, where it won the Galbraith prize, a major literary award. But then, in 1963, Sylvia Plath, a young American poet whom he had first met at Cambridge University in 1956, and who became his wife in the summer of that year, committed suicide. Hughes was vilified for long after that, especially by feminists in America. In 1998, the year he died, Hughes broke his own self-imposed public silence about their relationship in a book of loose-weave poems called “Birthday Letters”.

In this new and exhilarating collection of real letters, Hughes returns to the issue of his first wife's death, which he calls his “big and unmanageable event”. He felt his talent muffled by the perpetual eavesdropping upon his every move. Not until he decided to publish his own account of their relationship did the burden begin to lighten.

The analysis is raw, pained and ruthlessly self-aware. For all the moral torment, the writing itself has the same rush and vigour that possessed Hughes's early poetry. Some books of letters serve as a personalised historical chronicle. Poets' letters are seldom like that, and Hughes's are no exception. His are about a life of literary engagement: almost all of them include some musing on the state or the nature of writing, both Hughes's own or other people's. The trajectory of Hughes's literary career had him moving from obscurity to fame, and then, in the eyes of many, to life-long notoriety. These letters are filled with his wrestling with the consequences of being the part-private, part-public creature that he became, desperate to devote himself to his writing, and yet subject to endless invasions of his privacy.

Hughes is an absorbing and intricate commentator upon his own poetry, even when he is standing back from it and good-humouredly condemning himself for “its fantasticalia, its pretticisms and its infinite verballifications”. He also believed, from first to last, that poetry had a special place in the education of children. “What kids need”, he wrote in a 1988 letter to the secretary of state for education in the Conservative government, “is a headfull [sic] of songs that are not songs but blocks of refined and achieved and exemplary language.” When that happens, children have “the guardian angel installed behind the tongue”. Lucky readers, big or small.

Letters of Ted Hughes.
Edited by Christopher Reid.
Faber and Faber; 756 pages; £30

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America's hotel industry

Hamilton's hostelries

Nov 22nd 2007
From The Economist print edition

HOTELS are not usually seen as being at the core of a nation's culture. But Andrew Sandoval-Strausz, an assistant professor at the University of New Mexico, makes two grand claims for the American hospitality industry: that America made hotels what they are today and, more startlingly, that hotels helped make America.

Hotel: An American History
By A.K. Sandoval-Strausz

Yale University Press; 375 pages; $37.50 and £25

Buy it at
Amazon.com
Amazon.co.uk

The first is easier to establish. In 1838, a visitor dubbed the new Queen's Hotel in Cheltenham “the finest hotel in Europe”. Yet it was modest compared with large American hotels of the period. They had 400-500 bedrooms; it had 79.

Americans invented the grand hotel. They also launched the standardised one. E.M. Statler made his fortune creating hotels for world fairs and other commercial exhibitions in the Midwest: they were enormous, cheap and flimsy—designed to be used for one year with 100% occupancy before being pulled down and sold for scrap. Statler's first permanent hotel, in Buffalo, opened the year the Model T Ford was launched, and, like it, used standardisation and large-scale production. Statler created the model that Conrad Hilton, J. Willard Marriott and Howard Deering Johnson (Americans all) used when setting up what were to become typical hotel businesses, and business hotels.

But Mr Sandoval-Strausz argues that, in their origins, American hotels were never merely commercial. They were intimately bound up with civic pride and democracy. And that helps explain both his second claim—that hotels helped make America—and why the modern hotel developed in America in the first place.

After the revolutionary wars, the first new buildings in America's main cities were almost always a state house, a governor's mansion—and a hotel, which was frequently larger and more expensive than the other two. The Union Public Hotel in Washington, DC, was so grandiose it bankrupted its backer. Boston's Exchange Coffee House was said to be the largest building in the country when it opened in 1809.

Hotels were also bound up with politics. Tammany Hall—epitome of political corruption—was a hotel. In the run up to the civil war, hotels became settings for some of the main episodes in the conflict. The split in the Democratic Party between northerners and southerners in 1860 occurred at the Charleston Hotel; the Republican Party's decision to unite around Lincoln came at the Tremont Hotel in Chicago; the peace conference that failed to resolve the gathering crisis took place at the Willard in Washington, DC.

Such hotels were not just stage sets. Many of them were connected, Mr Sandoval-Strausz shows, with a particular party, and embodied that party's view of America. Many of the early hotels were built or sponsored by Federalists—the party of merchants and businessmen founded by Alexander Hamilton. In a narrow sense, hotels expressed the local power of the commercial elite that built them.

Federalists had a broader agenda. They were urban and commercially minded, and they believed in a strong central government. During the 1790s, they wrangled with their opponents, led by Thomas Jefferson, about the kind of country America should be. The Jeffersonians supported farmers over monied interests and opposed centralising policies such as creating a national bank.

The Federalists needed to show that they could keep a large republic together without sacrificing democracy, at a time when many political theorists thought a monarchy was required to keep a large country united. Commercial links were an essential bit of their case. James Madison asserted that a central government could indeed rule justly assuming “accommodations for travellers will be multiplied and meliorated”. Hotels, in other words, were not just places to stay: they were instruments to help

create an urban, commercial democracy. Stretching the argument, perhaps; but an interesting thought to ponder next time you lie awake in a soulless box near the airport.

Hotel: An American History.
By A.K. Sandoval-Strausz.
Yale University Press; 375 pages; $37.50 and £25

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Helene Schjerfbeck

Paint appeal

Nov 22nd 2007 | PARIS
From The Economist print edition

Posthumous glory for a Finnish star

Musée d'Art moderne

Halfway through life

THE haunting paintings of Helene Schjerfbeck, on show in the final leg of a travelling tour that has already attracted thousands of visitors in Hamburg and The Hague, may come as a surprise to many. Few outside the Nordic world would recognise the work of this Finnish artist who died in 1946. More people should.

The 120 works have at their core 20 self-portraits, half the number she painted in all. The first, dated 1880, is of a wide-eyed teenager eager to absorb everything. The last is a sighting of the artist's ghost-to-be; Schjerfbeck died the year after it was made. Together this series is among the most moving and accomplished autobiographies-in-paint.

Precociously gifted, Schjerfbeck was 11 when she entered the Finnish Art Society's drawing school. “The Wounded Warrior in the Snow”, a history painting, was bought by a private collector and won her a state travel grant when she was 17. Schjerfbeck studied in Paris, went on to Pont-Aven, Brittany, where she painted for a year, then to Tuscany, Cornwall and St Petersburg.

During her 1887 visit to St Ives, Cornwall, Schjerfbeck painted “The Convalescent”. A child wrapped in a blanket sits propped up in a large wicker chair, toying with a sprig. The picture won a bronze medal at the 1889 Paris World Fair and was bought by the Finnish Art Society. To a modern eye it seems almost sentimental and is redeemed only by the somewhat stunned, melancholy expression on the child's face, which may have been inspired by Schjerfbeck's early experiences. At four, she fell down a flight of steps and never fully recovered.

In 1890, Schjerfbeck settled in Finland. Teaching exhausted her, she did not like the work of other local painters, and she was further isolated when she took on the care of her mother (who lived until 1923). “If I allow myself the freedom to live a secluded life”, she wrote, “then it is because it has to be that way.” In 1902, Schjerfbeck and her mother settled in the small, industrial town of Hyvinkaa, 50 kilometres north of Helsinki.

Isolation had one desired effect for it was there that Schjerfbeck became a modern painter. She produced still lives and landscapes but above all moody yet incisive portraits of her mother, local school girls, women workers in town (profiles of a pensive, aristocratic looking seamstress dressed in black stand out). And of course she painted herself. Comparisons have been made with James McNeill Whistler and Edvard Munch. But from 1905, her pictures became pure Schjerfbeck.

“I have always searched for the dense depths of the soul, that have not yet discovered themselves”, she wrote, “where everything is still unconscious—there one can make the greatest discoveries.” She experimented with different kinds of underpainting, scraped and rubbed, made bright rosy red spots; doing whatever had to be done to capture the subconscious—her own and that of her models.

In 1913, Schjerfbeck was rediscovered by an art dealer and journalist, Gosta Stenman. Once again she was a success. Retrospectives, touring exhibitions and a biography followed, yet Schjerfbeck remained little known outside Scandinavia. That may have had something to do with her indifference to her renown. “I am nothing, absolutely nothing”, she wrote. “All I want to do is paint”. Schjerfbeck was possessed of a unique vision, and it is time the world recognised that.

“Helene Schjerfbeck” is at the Musée d'Art Moderne de la Ville de Paris until January 13th 2008

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Ian Smith

Nov 22nd 2007
From The Economist print edition

Topfoto

Ian Smith, a rebellious Rhodesian, died on November 20th, aged 88

Get article background

AMONG the white tribes of Africa, it used to be said, the Rhodesians stood out for their ordinariness. This was often a nakedly snobbish observation, accompanied by the comment that the British colonists who went to Kenya tended to be officers, whereas those settling in Southern Rhodesia were NCOs. And, like lots of generalisations, it was too simple. Many Rhodesians were far from ordinary: just look at Doris Lessing, the latest Nobel laureate for literature, or Merle Park, a ballet dancer of renown. Yet some Rhodesians themselves took a certain pride in their unflashy, down-to-earth qualities, their tenacity, patriotism and concern for standards. These were sportsmen, farmers and ex-servicemen, with decent, uncomplicated values, who believed they knew how to look after their land and their workers. These were people like Ian Smith.

When Mr Smith first went to Salisbury, it was a bit like Mr Smith going to Washington. He was a farmer, the 29-year-old son of a Scottish-by-birth butcher, born in a village in the middle of the country and distinguished at school both for his athletic prowess and for his qualities of leadership. And Salisbury, in which he found himself the youngest member of parliament, was the capital of Britain's most hopeful colony in central Africa.

Mr Smith was already something of a hero. He had interrupted his studies at Rhodes University in South Africa to fight the Germans as a pilot in the Royal Air Force. A crash in Egypt had left one of his eyes badly damaged and one side of his face impassive. A year later, in 1944, his Spitfire had been shot down over Italy. After five months with partisans, he had made a dashing journey to safety. About none of this was he boastful.

The pity of his wartime experiences, though, was that they did not open his mind to the inevitability of change in the post-war world, still less to the need for it in Africa. His entire political career was to be devoted to resisting black majority rule. Though he fought his rearguard action with ruthlessness and skill, and though it delayed the transformation of white-dominated Rhodesia into black-ruled Zimbabwe by 15 or more years, it was from the outset doomed to futility. The price paid included an embittered nation and the lives of some 30,000 people, nearly all of them black Zimbabweans.

As a politician, Mr Smith was both ambitious and tactically shrewd, qualities that brought him to the prime ministership in 1964; but he lacked imagination. He had heard Harold Macmillan, Britain's prime minister, talking of the “wind of change” in Africa and then seen chaos as the Belgians scuttled from the Congo. But instead of trying to tame the storm by seeking accommodation with Southern Rhodesia's black leaders—admittedly, a quarrelsome lot—he locked them up. In 1965, in a feebly disguised attempt

at matching America's precedent of 1776, he declared Rhodesia independent. Illegal it might be, but only thus, he said, could turmoil be avoided and “civilised standards” maintained.

Turmoil was not avoided: the insurgency of 1972-79 was proof of that. But subsequent events have, in some eyes, vindicated Mr Smith. Under President Robert Mugabe, Zimbabwe is surely more miserable now than it was in his day. Even so, that hardly proves “good old Smithy” right, any more than Mr Mugabe's tyranny diminishes Mr Smith's.

Mr Smith's quest could not be justified on the dubious principle of the end justifying the means: it was impossible. Even his South African friends, who had sustained Rhodesia through ten years of UN sanctions, came to see that 3% of the population could not for ever hold down 97%. By 1974 John Vorster, staunch defender of apartheid, was beginning to squeeze him. Henry Kissinger, as America's secretary of state, was even blunter two years later.

Nor were the standards that Mr Smith so volubly sought to maintain very civilised. Democracy, of the one-man-one-vote variety, was certainly not among them. Nationalists were, in his eyes, synonymous with communists, if not terrorists. But then he had little respect for the dignity of man. If the racism of his party, the Rhodesian Front, was less crude than that practised in Portugal's African possessions, and less formalised than in South Africa, it was racism just the same.

Reality in black and white

The word apologists used to describe Mr Smith was paternalist, and his Rhodesia was sometimes cast as nothing worse than a slightly more rough-and-tumble version of the British home counties: Surrey with the lunatic fringe on top. It certainly lacked the more overt manifestations of racism in South Africa, but segregation of the races in schools, hospitals and residential areas was nonetheless the norm, and most of the humiliations of apartheid could be found in abundance. Public spending was vastly skewed towards whites; land ownership, perhaps the bitterest of political issues, was fiercely inequitable.

So Mr Smith's rebellion really had no similarities to the American revolt 200 years earlier. As rebels go, he had rather more in common with the Dixie variety. But in truth there was no romance about Mr Smith's Rhodesia—no heroes, no derring-do, no nobility of purpose. It wasn't so much ordinary, just rather squalid.

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Overview

Nov 22nd 2007
From The Economist print edition

Oil prices reached a new record. The price of a barrel of West Texas Intermediate crude touched $99.29 on November 21st. The **euro** climbed to a fresh high of $1.486.

The **Federal Reserve** expects GDP in America to expand by around 2.5% in 2010, a fairly gloomy assessment of medium-term growth prospects. In its new extended forecasts, which will appear four times a year, the Fed projects an inflation rate of 1.6-1.9% in three years' time, a forecast that will be interpreted as a target. The Fed now thinks the economy will grow by 1.8-2.5% next year, half a percentage point less than it had expected in June.

Industrial output in **America** fell by 0.5% in October. Housing starts rose by 3% that month, but were 16.4% lower than a year earlier.

The **Bank of England's** decision to keep interest rates at 5.75% earlier this month was split. The minutes to the meeting show that two members of the nine-strong monetary-policy committee voted to cut rates to 5.5% on November 7th. The pound fell to its lowest level against the euro for four years, on expectations of a rate cut soon.

GDP in **Norway** rose by a healthy 1.4% in the third quarter.

Consumer prices in **Canada** rose by 2.4% in the year to October. The core measure, which excludes volatile components such as food and energy, rose by 1.8%, close to the mid-point of the Bank of Canada's target range.

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Output, prices and jobs

Nov 22nd 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2007†	2008†	latest	latest	year ago	2007†	rate‡, %
United States	+2.6 Q3	+3.9	+2.0	+2.1	+1.8 Oct	+3.5 Oct	+1.3	+2.8	4.7 Oct
Japan	+2.1 Q3	+2.6	+2.0	+1.8	+0.8 Sep	–0.2 Sep	+0.6	nil	4.0 Sep
China	+11.5 Q3	na	+11.5	+10.0	+17.9 Oct	+6.5 Oct	+1.4	+4.5	9.5 2006
Britain	+3.3 Q3	+3.2	+3.0	+2.1	–0.3 Sep	+2.1 Oct§	+2.4	+2.2	5.4 Sep††
Canada	+2.5 Q2	+3.6	+2.6	+2.3	+0.2 Aug	+2.4 Oct	+1.0	+2.2	5.8 Oct
Euro area	+2.6 Q3	+2.8	+2.6	+2.0	+3.5 Sep	+2.6 Oct	+1.6	+2.0	7.3 Sep
Austria	+3.4 Q3	+3.0	+3.2	+2.6	+7.5 Aug	+2.8 Oct	+1.2	+1.9	4.2 Oct
Belgium	+2.5 Q3	+1.6	+2.6	+2.0	nil Sep	+2.2 Oct	+1.2	+1.7	11.1 Oct‡‡
France	+2.1 Q3	+2.9	+1.8	+1.9	+1.6 Sep	+1.5 Sep	+1.2	+1.4	8.1 Q2
Germany	+2.5 Q3	+2.8	+2.6	+2.1	+6.1 Sep	+2.4 Oct	+1.1	+2.1	8.7 Oct
Greece	+3.6 Q3	na	+3.8	+2.9	+1.7 Sep	+3.1 Oct	+2.8	+2.8	7.6 Aug
Italy	+1.9 Q3	+1.5	+1.7	+1.4	+0.3 Sep	+2.1 Oct	+1.8	+1.9	6.0 Q2
Netherlands	+4.1 Q3	+7.2	+2.5	+2.2	+2.3 Sep	+1.6 Oct	+1.1	+1.7	4.3 Oct††
Spain	+3.8 Q3	+2.8	+3.7	+2.7	+0.6 Sep	+3.6 Oct	+2.5	+2.6	8.0 Sep
Czech Republic	+6.0 Q2	+5.7	+5.7	+4.5	+1.2 Sep	+4.0 Oct	+1.3	+2.6	5.8 Oct
Denmark	+0.6 Q2	–1.6	+1.6	+1.7	–0.6 Sep	+1.7 Oct	+1.5	+1.6	3.1 Sep
Hungary	+1.0 Q3	+1.2	+2.1	+3.0	+8.7 Sep	+6.7 Oct	+6.3	+7.8	7.2 Sep††
Norway	+3.1 Q3	+5.6	+3.3	+2.6	+0.3 Sep	–0.2 Oct	+2.7	+0.4	2.5 Sep††
Poland	+6.4 Q2	na	+6.5	+5.2	+10.6 Oct	+3.0 Oct	+1.2	+2.2	11.6 Sep‡‡
Russia	+7.8 Q2	na	+7.2	+6.4	+6.1 Oct	+9.5 Sep	+9.5	+8.6	6.0 Sep‡‡
Sweden	+3.5 Q2	+3.7	+3.4	+3.0	+1.1 Sep	+2.7 Oct	+1.3	+1.8	5.7 Oct‡‡
Switzerland	+2.8 Q2	+3.0	+2.6	+2.0	+9.8 Q2	+1.2 Oct	+0.3	+0.6	2.6 Oct‡‡
Turkey	+3.9 Q2	na	+5.2	+5.1	+2.2 Sep	+7.0 Oct	+10.0	+8.5	9.2 Q3‡‡
Australia	+4.3 Q2	+3.8	+4.2	+3.7	+4.6 Q2	+1.9 Q3	+3.9	+2.4	4.3 Oct
Hong Kong	+6.2 Q3	+7.0	+6.1	+4.5	–2.3 Q2	+3.2 Oct	+2.0	+2.0	3.9 Oct††
India	+9.3 Q2	na	+8.0	+7.9	+6.4 Sep	+6.4 Sep	+6.8	+6.2	7.6 2006
Indonesia	+6.5 Q3	na	+6.2	+6.1	–1.4 Sep	+6.9 Oct	+6.3	+6.3	9.8 Feb
Malaysia	+5.7 Q2	na	+6.0	+5.8	+3.4 Sep	+1.9 Oct	+3.1	+2.0	3.4 Q2
Pakistan	+7.0 2007**	na	+6.4	+5.9	+9.3 Aug	+8.4 Sep	+8.7	+6.9	6.2 2006††
Singapore	+9.4 Q3	+6.4	+7.4	+4.9	–2.8 Sep	+2.7 Sep	+0.4	+1.8	1.7 Q3
South Korea	+5.2 Q3	+1.4	+5.0	+4.7	+0.3 Sep	+3.0 Oct	+2.2	+2.5	3.1 Oct
Taiwan	+6.9 Q3	na	+4.3	+4.4	+8.1 Sep	+5.3 Oct	–1.2	+1.1	3.9 Oct
Thailand	+4.4 Q2	+5.2	+4.5	+4.9	+9.2 Sep	+2.5 Oct	+2.8	+2.0	1.2 Aug
Argentina	+8.7 Q2	+8.8	+8.0	+5.9	+1.5 Sep	+8.4 Oct	+10.5	+8.9	7.9 Q3‡‡
Brazil	+5.4 Q2	+3.2	+4.7	+4.5	+5.6 Sep	+4.1 Oct	+3.3	+3.6	9.0 Sep‡‡
Chile	+6.1 Q2	+6.5	+5.6	+5.5	+1.3 Sep	+6.5 Oct	+2.1	+4.1	7.7 Sep††‡‡
Colombia	+6.9 Q2	+4.4	+6.7	+5.6	+6.0 Sep	+5.2 Oct	+4.2	+5.5	10.6 Sep‡‡
Mexico	+3.3 Q3	+5.9	+3.0	+2.9	+0.4 Sep	+3.7 Oct	+4.3	+4.0	3.9 Oct‡‡
Venezuela	+8.7 Q3	na	+6.9	+4.8	+14.1 Jul	+17.2 Oct	+15.5	+17.8	8.4 Q2‡‡
Egypt	+7.2 Q2	na	+7.1	+7.3	+7.5 2007**	+7.5 Oct	+11.8	+9.2	8.1 Q2‡‡
Israel	+4.4 Q2	+6.1	+5.3	+4.4	–3.3 Sep	+2.2 Oct	–0.2	+0.4	7.6 Q2
Saudi Arabia	+4.3 2006	na	+4.7	+5.6	na	+4.9 Sep	+2.5	+4.0	na
South Africa	+5.0 Q2	+4.5	+4.7	+5.1	–1.4 Sep	+7.2 Sep	+5.3	+6.0	25.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+6.4 Q3	+7.4	+7.9	+5.3	+5.8 Sep	+8.5 Oct	+3.7	+6.1	5.7 Sep
Finland	+4.7 Q2	+3.8	+4.6	+2.5	+1.1 Sep	+2.7 Oct	+1.8	+2.7	7.0 Oct
Iceland	+2.5 Q2	+9.1	+1.8	+2.1	+7.6 2006	+5.2 Nov	+7.3	+4.9	0.8 Oct‡‡
Ireland	+5.4 Q2	–5.5	+4.6	+3.5	+4.3 Sep	+4.6 Sep	+4.0	+4.7	4.8 Oct
Latvia	+11.1 Q3	na	+10.7	+7.5	nil Sep	+13.2 Oct	+5.6	+10.1	5.2 Sep
Lithuania	+10.8 Q3	+10.0	+7.8	+6.9	na	+7.6 Oct	+3.6	+5.4	4.2 Oct
Luxembourg	+5.3 Q2	+5.3	+5.0	+3.4	–2.0 Aug	+2.9 Oct	+1.5	+2.1	4.2 Sep‡‡
New Zealand	+3.8 Q2	+3.4	+3.1	+2.8	+0.5 Q2	+1.8 Q3	+3.5	+2.5	3.5 Q3
Peru	+8.8 Sep	na	+7.5	+6.5	+9.4 Sep	+3.1 Oct	+1.9	+1.7	8.4 Sep‡‡
Philippines	+7.5 Q2	+7.1	+6.9	+5.0	–4.7 Aug	+2.7 Oct	+5.4	+2.7	7.8 Q3‡‡
Portugal	+1.8 Q3	nil	+1.8	+2.0	+1.4 Sep	+2.1 Sep	+3.0	+2.3	7.9 Q3‡‡
Slovakia	+9.4 Q3	na	+8.5	+6.5	+15.4 Sep	+3.3 Oct	+3.7	+2.7	8.3 Sep
Slovenia	+5.9 Q2	na	+5.6	+4.6	+2.9 Sep	+5.1 Oct	+1.5	+3.2	7.2 Sep‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate 4.2% in Oct. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Nov 22nd 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Nov 13th	Nov 20th*	% change on one month	% change on one year
Dollar index				
All items	212.7	210.2	−2.8	+15.7
Food	193.7	197.8	+1.9	+30.5
Industrials				
All	237.3	226.2	−7.6	+2.6
Nfa†	175.6	174.4	+2.1	+30.1
Metals	271.1	254.6	−10.8	−4.9
Sterling index				
All items	155.7	154.4	−3.6	+6.5
Euro index				
All items	134.7	131.5	−6.3	+0.4
Gold				
$ per oz	799.60	793.25	+4.8	+26.2
West Texas Intermediate				
$ per barrel	91.40	99.07	+16.2	+71.2

*Provisional †Non-food agriculturals.

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Entrepreneurship

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Only 6.5% of new firms are likely to grow quickly enough to need more than 20 employees within the next five years, according to a report by the Global Entrepreneurship Monitor and Mazars, an accounting firm. Entrepreneurs were asked how many people they expect to hire in their early years. Based on the responses, 90% of jobs will be created by less than a quarter of new firms. Nearly half of all start-ups do not expect to hire any staff at all. China has the highest number of entrepreneurs per head, with 17 per thousand. Russian start-ups are the most confident about creating jobs. America scores well on both counts: it has lots of entrepreneurs and many of these expect to employ at least 20 workers.

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Trade, exchange rates, budget balances and interest rates

Nov 22nd 2007
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†	Currency units, per $ Nov 21st	Currency units, per $ year ago	Budget balance % of GDP 2007†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−805.0 Sep	−793.2 Q2	−5.5	–	–	−1.2	4.40	4.05
Japan	+104.0 Sep	+205.0 Sep	+4.7	108	117	−2.6	0.73	1.44
China	+256.5 Oct	+249.9 2006	+10.9	7.41	7.86	0.2	4.32	4.93
Britain	−164.4 Sep	−86.6 Q2	−3.3	0.49	0.52	−3.0	6.21	4.59
Canada	+48.4 Sep	+21.9 Q2	+1.7	0.99	1.14	1.0	3.92	4.00
Euro area	+44.5 Sep	+27.9 Aug	+0.1	0.67	0.77	−0.9	4.65	4.01
Austria	+1.5 Aug	+12.3 Q2	+2.9	0.67	0.77	−0.5	4.65	4.15
Belgium	+18.9 Sep	+13.0 Jun	+2.4	0.67	0.77	−0.1	4.72	4.22
France	−44.4 Sep	−28.0 Sep	−1.1	0.67	0.77	−2.4	4.65	4.15
Germany	+239.3 Sep	+204.5 Sep	+5.6	0.67	0.77	−0.4	4.65	4.01
Greece	−51.1 Aug	−41.7 Sep	−13.1	0.67	0.77	−2.7	4.65	4.38
Italy	−13.6 Sep	−47.7 Sep	−2.5	0.67	0.77	−2.5	4.65	4.40
Netherlands	+51.1 Sep	+57.2 Q3	+7.8	0.67	0.77	−0.6	4.65	4.13
Spain	−124.1 Aug	−125.1 Jul	−9.1	0.67	0.77	1.8	4.65	4.21
Czech Republic	+3.5 Sep	−5.8 Sep	−3.5	18.1	21.6	−3.9	3.74	4.49
Denmark	+3.9 Sep	+4.0 Sep	+1.9	5.03	5.76	3.8	4.90	4.13
Hungary	−1.4 Sep	−6.8 Q2	−5.8	173	200	−6.0	7.44	6.80
Norway	+54.7 Oct	+54.6 Q2	+14.3	5.43	6.38	18.9	5.91	4.68
Poland	−11.3 Sep	−15.5 Sep	−4.3	2.49	2.95	−2.0	5.42	5.80
Russia	+121.5 Sep	+73.5 Q3	+5.6	24.3	26.6	4.0	10.00	6.33
Sweden	+18.3 Sep	+29.7 Q2	+7.1	6.30	7.02	2.8	3.90	4.19
Switzerland	+11.3 Oct	+64.9 Q2	+16.3	1.10	1.23	0.3	2.75	2.87
Turkey	−56.9 Sep	−34.4 Sep	−7.3	1.21	1.48	−2.8	16.95	6.40‡
Australia	−13.6 Sep	−47.1 Q2	−5.7	1.15	1.29	1.6	7.18	5.91
Hong Kong	−21.1 Sep	+24.9 Q2	+9.7	7.78	7.79	1.9	3.67	3.33
India	−65.4 Sep	−9.7 Q2	−1.2	39.4	44.8	−3.3	7.50	8.25
Indonesia	+41.3 Sep	+11.0 Q2	+2.5	9,405	9,134	−1.7	8.15	6.83‡
Malaysia	+29.1 Sep	+27.6 Q2	+13.5	3.38	3.65	−3.2	3.62	4.25‡
Pakistan	−15.0 Oct	−7.1 Q2	−4.6	60.9	60.8	−4.6	9.79	9.00‡
Singapore	+37.4 Oct	+46.3 Q3	+27.4	1.45	1.55	0.3	2.50	2.80
South Korea	+19.1 Oct	+9.1 Sep	+0.4	929	934	0.4	5.40	5.67
Taiwan	+15.7 Oct	+28.4 Q3	+6.4	32.3	32.8	−2.0	2.60	2.69
Thailand	+9.7 Sep	+11.8 Sep	+3.6	33.8	36.6	−1.9	3.55	4.78
Argentina	+10.5 Sep	+7.4 Q2	+2.8	3.14	3.08	1.4	14.06	na
Brazil	+42.6 Oct	+9.0 Sep	+0.7	1.79	2.16	−1.8	11.18	6.16‡
Chile	+24.7 Oct	+8.3 Q2	+4.8	512	529	8.1	5.88	4.37‡
Colombia	−1.9 Aug	−4.8 Q2	−3.8	2,071	2,284	−0.2	8.83	6.10‡
Mexico	−11.8 Sep	−7.0 Q2	−0.6	11.0	11.0	nil	7.46	8.11
Venezuela	+23.8 Q2	+20.4 Q2	+7.7	6,100	3,213	−2.2	11.12	6.55‡
Egypt	−15.8 Q2	+2.7 Q2	+1.8	5.52	5.72	−7.5	7.15	5.41‡
Israel	−9.5 Oct	+7.8 Q2	+3.7	3.89	4.31	−0.5	4.26	5.21
Saudi Arabia	+146.6 2006	+98.9 2006	+23.2	3.73	3.75	18.9	4.76	na
South Africa	−11.0 Sep	−17.4 Q2	−6.3	6.83	7.17	0.5	11.05	8.37
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−4.1 Aug	−3.1 Aug	−14.6	10.6	12.1	3.1	5.20	na
Finland	+12.8 Sep	+13.2 Sep	+7.1	0.67	0.77	4.2	4.54	4.14
Iceland	−1.8 Oct	−3.7 Q2	−16.9	62.4	71.6	5.3	14.13	na
Ireland	+36.6 Aug	−10.5 Q2	−5.2	0.67	0.77	1.1	4.65	4.24
Latvia	−7.2 Sep	−6.3 Aug	−22.2	0.47	0.54	0.4	9.99	na
Lithuania	−6.6 Sep	−4.5 Sep	−14.5	2.33	2.67	−0.5	6.48	na
Luxembourg	−5.8 Aug	+4.6 Q2	na	0.67	0.77	0.3	4.65	na
New Zealand	−4.4 Sep	−9.2 Q2	−8.1	1.33	1.49	4.8	7.10	6.29
Peru	+8.6 Aug	+2.8 Q2	+1.1	3.01	3.23	0.7	5.00	na
Philippines	−4.1 Aug	+6.4 Jun	+5.9	43.3	49.7	−0.9	6.69	na
Portugal	−23.8 Aug	−18.1 Aug	−8.5	0.67	0.77	−3.0	4.65	4.29
Slovakia	−1.1 Sep	−3.8 Jul	−4.4	22.5	27.6	−2.9	4.18	4.60
Slovenia	−2.6 Sep	−1.4 Aug	−3.2	0.67	0.77	−0.5	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Nov 22nd 2007
From The Economist print edition

Markets

	Index Nov 21st	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	12,799.0	–3.3	+2.7	+2.7
United States (S&P 500)	1,416.8	–3.7	–0.1	–0.1
United States (NAScomp)	2,562.2	–3.1	+6.1	+6.1
Japan (Nikkei 225)	14,837.7	–4.3	–13.9	–5.3
Japan (Topix)	1,438.7	–3.9	–14.4	–5.9
China (SSEA)	5,473.1	–3.7	+94.4	+104.8
China (SSEB, $ terms)	345.7	+0.3	+152.3	+165.7
Britain (FTSE 100)	6,070.9	–5.6	–2.4	+2.5
Canada (S&P TSX)	13,280.6	–3.6	+2.9	+20.9
Euro area (FTSE Euro 100)	1,314.4	–3.9	+2.8	+15.6
Euro area (DJ STOXX 50)	4,195.6	–3.3	+1.8	+14.5
Austria (ATX)	4,171.9	–7.3	–6.5	+5.1
Belgium (Bel 20)	3,882.4	–6.3	–11.5	–0.6
France (CAC 40)	5,381.3	–4.1	–2.9	+9.2
Germany (DAX)*	7,518.4	–3.4	+14.0	+28.1
Greece (Athex Comp)	4,818.3	–6.9	+9.7	+23.3
Italy (S&P/MIB)	37,358.0	–3.2	–9.8	+1.4
Netherlands (AEX)	483.5	–5.6	–2.4	+9.7
Spain (Madrid SE)	1,662.9	–2.9	+6.9	+20.2
Czech Republic (PX)	1,728.2	–5.5	+8.8	+25.6
Denmark (OMXCB)	424.2	–8.9	nil	+12.4
Hungary (BUX)	25,310.3	–4.4	+1.9	+12.2
Norway (OSEAX)	546.4	–5.2	+8.8	+24.8
Poland (WIG)	54,670.6	–4.7	+8.4	+26.5
Russia (RTS, $ terms)	2,151.9	–4.1	+3.5	+12.0
Sweden (Aff.Gen)	329.9	–6.4	–9.7	–1.9
Switzerland (SMI)	8,125.4	–5.9	–7.5	+2.2
Turkey (ISE)	52,615.6	–5.5	+34.5	+57.3
Australia (All Ord.)	6,450.2	–3.0	+14.3	+26.2
Hong Kong (Hang Seng)	26,618.2	–8.7	+33.3	+33.3
India (BSE)	18,602.6	–6.7	+34.9	+51.6
Indonesia (JSX)	2,563.6	–4.8	+42.0	+35.8
Malaysia (KLSE)	1,359.9	–1.8	+24.0	+29.4
Pakistan (KSE)	13,509.0	+1.5	+34.5	+34.5
Singapore (STI)	3,347.2	–5.0	+12.1	+18.2
South Korea (KOSPI)	1,807.0	–8.4	+26.0	+26.1
Taiwan (TWI)	8,484.1	–5.1	+8.4	+9.2
Thailand (SET)	807.6	–6.3	+18.8	+27.0
Argentina (MERV)	2,216.2	–4.0	+6.0	+3.6
Brazil (BVSP)	60,581.0	–6.3	+36.2	+62.4
Chile (IGPA)	13,947.4	–5.0	+12.7	+17.2
Colombia (IGBC)	11,157.2	+1.8	nil	+8.1
Mexico (IPC)	28,446.5	–4.1	+7.6	+5.7
Venezuela (IBC)	37,822.0	–1.4	–27.6	–60.3
Egypt (Hermes)	86,358.6	+4.2	+40.9	+45.8
Israel (TA-100)	1,109.9	–3.8	+20.4	+30.7
Saudi Arabia (Tadawul)	9,518.9	+2.7	+20.0	+20.6
South Africa (JSE AS)	29,146.4	–5.0	+17.0	+20.7
Europe (FTSEurofirst 300)	1,443.2	–5.2	–2.7	+9.4
World, dev'd (MSCI)	1,542.6	–4.1	+4.0	+4.0
Emerging markets (MSCI)	1,188.5	–7.1	+30.2	+30.2
World, all (MSCI)	390.8	–4.4	+6.2	+6.2
World bonds (Citigroup)	743.8	+1.8	+13.0	+13.0
EMBI+ (JPMorgan)	425.4	–1.0	+4.4	+4.4
Hedge funds (HFRX)	1,327.0	–1.2	+4.0	+4.0
Volatility, US (VIX)	26.8	25.9	11.6	(levels)
CDSs, Eur (iTRAXX)†	58.3	+12.4	+150.1	+181.1
CDSs, N Am (CDX)†	95.6	+22.6	+186.0	+186.0
Carbon trading (EU ETS) €‡	23.7	+3.5	+30.0	+46.1

*Total return index. †Credit-default swap spreads, basis points.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank

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Poverty in Africa

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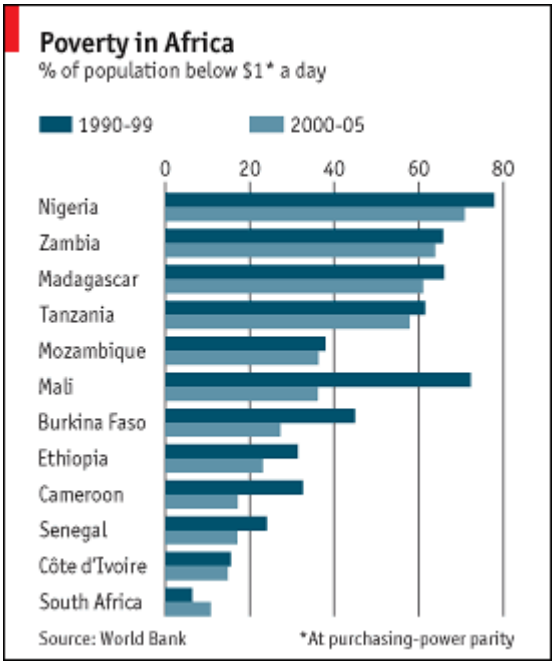
From The Economist print edition



The share of Mali's population living on less than a dollar a day has fallen by half, to 36%, since the mid-1990s, according to the latest African Development Indicators from the World Bank. By that benchmark, South Africa is the only country for which there are comparable data that has seen an increase in poverty this decade. The proportion of very poor Africans fell from 47% in 1990 to 41% in 2004. On present trends, it is set to fall to 37% by 2015. Nigeria's poverty rate of 70.8% is the highest among the countries covered by the report. Twenty-three African countries are unlikely to meet any of the Millennium Development Goals, including poverty reduction, by 2015. Thirteen countries will achieve at least one.

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